

HR Innovation* 2009



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Foreword

Recent economic developments around the world have left many companies faced with significant financial losses, while the workforce is increasingly doubtful over job security and the stability of their retirement investments and compensation structures. Indeed, it is a challenging time for the human resources (HR) function, and one that should be faced head-on. Rather than allowing the business shifts in today's economic landscape to dictate the role of HR, the HR function must be proactively involved every step of the way.

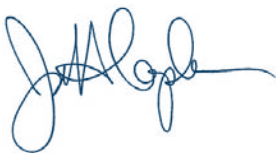
Aligning HR strategy with the overall business strategy is key to driving value and improving performance. Thus, HR must continue to fight to remain influential members of corporate leadership—bearing a strong influence on a wide range of important company decisions and strategic business planning.

Today's business leaders need the skills and knowledge to efficiently and effectively manage talent. In fact, PricewaterhouseCoopers' recent survey of CEOs around the world revealed that talent management is top-of-mind among them. But, attracting and retaining talent continues to be a major challenge for HR. In addition, changes in legislation, increased compliance burdens, economic volatility and complex tax rules create a host of issues for HR leaders working to address the needs of today's workforce.

HR Innovation is a collection of thought leadership articles that explore current issues requiring the attention of today's HR professionals. This publication, from PricewaterhouseCoopers' Human Resource Services practice, shares innovative approaches to such issues and provides HR decision makers with guidance on how to gain a competitive advantage in this changing marketplace.

In this edition, our HR consulting professionals cover timely topics, including executive severance arrangements, HR measurement and the workforce intelligence center of excellence, healthcare cost containment, plan governance, pensions for the globally mobile workforce, approaches to retiree medical coverage, and executive compensation disclosure.

I hope you will agree that *HR Innovation* addresses today's challenges and offers insightful ways to help turn them into opportunities—and to help keep your organization one step ahead of the challenges we will face tomorrow.



John Caplan
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How to succeed in a connected world: US perspectives for global objectives

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Preface

The credit and financial crises that started in 2007 and wreaked global havoc as 2008 flowed into 2009 provide a sobering reminder that change, often unpredicted, can have a negative impact on even the most prepared organizations. A plethora of top-level acumen contained in the results of two timely PricewaterhouseCoopers surveys illuminates crucial information for business leaders and human resources practitioners in particular—for it is they who can provide pivotal guidance in change management and human capital matters so critical to businesses struggling to balance long-term sustainability with short-term fiscal conservatism.

PricewaterhouseCoopers' 11th Annual Global CEO Survey¹ provides a compelling snapshot of the business world taken at a time when the current financial crisis was just emerging and prior to the dramatic shake-ups that continue to mar the economic landscape. The firm's 12th Annual Global CEO Survey² reiterates the imperative for businesses to prepare for change, to leverage people power, and to recognize the deep connectivity that characterizes our world today.

During 2007, the year the credit markets began their slide, we interviewed CEOs in 50 countries from September through November for our 2008 survey, eliciting feedback from a diverse cross section of top leaders in Western Europe (454 interviews), Asia Pacific (277), Latin America (136), North America (130, including 30 in Canada), Eastern Europe (86), the Middle East and Africa (37), and Mexico (30). We repeated the process with similar numbers for our 2009 survey, just as Wall Street and its global counterparts mirrored the credit market dive, launching enormous volatility in global markets.

Together, these survey results, arriving at a key moment in US and world history, point the way forward. The rich accumulation of insights has become even more relevant given the challenging events that have affected our markets and our world in recent years. The need for strong leadership, deft change management, and proactive involvement from the human resources function will be greater than ever before. The businesses that keep those goals and values in their sights will be well positioned to succeed. When the going gets tough, the tough stay focused.

¹ Referred to as 2008 survey.

² Referred to as 2009 survey.

People agenda at forefront as CEOs discuss challenges, solutions and change

As time goes on, the Earth rotates ever more slowly,³ yet the pace of human interaction around the globe moves faster and faster, with the world becoming increasingly complex and connected. In this dynamic environment, business leaders grapple with new models and fresh vistas on an ongoing basis, as economic, demographic, and business imperatives converge and shift.

With the business world facing unprecedented challenges and opportunities, our CEO surveys reveal the views of top corporate leaders, identifying workforce concerns as a main focus for CEOs worldwide, with US business leaders particularly engaged in human resources (HR) issues. The primacy of HR issues—the people agenda—is a clear outgrowth of current economic, business, and cultural dynamics. Fast-paced globalization—powerfully evoked by the ferocity with which interconnected world markets tumbled in 2008—drives this focus, compelling companies to reassess HR, investment, and risk management policies.

The connected world is still a fresh reality, and many of the changes taking place are as intriguing and uncharted as a newly discovered planet. The various factors impacting today's marketplace suggest an extraordinary time for business and society—one in which companies will have to find new ways to achieve stability and build wealth by balancing the impetus to cut costs with the need to preserve long-term viability.

These changes are likely to far exceed mere refinements to traditional business practices. PwC's global CEO surveys provide an inside glimpse into top executive thinking on these historic shifts and the backdrop of turbulent economic times against which they occur, with specific focus on the US business implications. The findings are then compared with the current state of the HR function and translated into how these issues are changing the face of human resources.

³ Donald L. Hamilton, *The Mind of Mankind*, Suna Press, November 1996.

The people agenda is our agenda: US insights and perspectives

Challenging times often tempt knee jerk reactions in pursuit of cost cutting relief. And staff is a vulnerable area for apparent quick fixes that can easily backfire. Cuts to training programs undermine a company's ability to achieve sustainable growth, while slashing international assignments can preclude access to robust geographic markets.

CEOs we surveyed recognize the critical nature of the people agenda, although the current state of the economy has shifted focus to some extent. C-suite leadership remains aware that attracting and retaining key talent is crucial to long-term growth, particularly considering current demographic challenges. Globally, a whopping 97 percent of respondents to the 2009⁴ survey saw getting and keeping top performers as critical or important to sustaining long-term growth.

Respondents to the earlier survey were already convinced of the gravity of HR issues. Nearly all (94 percent) US CEOs contributing to the 2008⁵ survey reported that working on their organizations' people agenda is a top priority. The group overwhelmingly deemed this the right emphasis, with 83 percent agreeing that their time is best spent on matters pertaining to human capital. Global numbers also were impressive, with 90 percent viewing HR as a top priority and 67 percent endorsing that focus.

While sometimes misperceived as a "softer" issue, the people agenda and related matters continue to weigh heavily in CEOs' assessments of business challenges and opportunities. Respondents cited significant concerns about managing change, attracting and retaining talent, and the capability of the HR function to respond effectively to existing and emerging needs.

CEOs express ongoing concern about key skills shortages and their implications for business growth. They also see systemic vulnerabilities in change dexterity, citing in the 2008 survey shortcomings among middle and senior management as serious impediments to success. The leaders also communicated doubt regarding the ability of their HR functions to navigate change, attract and develop talent, and integrate acquisitions.

4 Based on feedback from more than 1,000 executives representing 50 countries.

5 Based on feedback from 150 US CEOs and 1,000 more executives representing 50 countries.

The people agenda ranks among top issues, major challenges, and opportunities

For the first time in the survey's decade-plus history, prescient CEOs who participated in the 2008 survey ranked the potential downturn in major world economies as the top threat to business growth, with 69 percent of US and more than 60 percent of global respondents citing this concern. Yet even as they cast a wary eye on economic developments, US CEOs gave almost equal weight to the people agenda.

The people agenda figured prominently when CEOs were asked to identify sources of competitive advantage, with 92 percent of US leaders ranking access to and retention of key talent a major competitive advantage, alongside the ability to adapt to change (93 percent). When CEOs were asked to rank the eight possible elements contributing to their competitive edge, these issues surpassed such matters as technological innovation, cross-cultural experience, and supply chain management.

CEO concerns about access to key talent dipped slightly in the 2009 survey, but top executives remain firmly focused on people as a crucial component of long-term competitiveness, with flexible work environments seen as the key to overcoming an array of people and talent challenges:

- a limited supply of candidates with the right skills
- challenges in recruiting and integrating younger employees
- providing attractive career paths
- competitors recruiting top performers
- key employees making career changes for personal reasons

These findings are consistent with 2008 results, in which business leaders said they were approaching the talent challenge through more creative means that reflect the changing dynamics of the labor market and the culture at large. Seventy-six percent saw value in redefining roles within their organizations. The same proportion favored developing talent from a more diverse pool, including women and retirees. Nearly 70 percent valued more flexible work environments. Notably, all of these solutions inherently bring with them more change and the imperative for increased institutional and professional dexterity.

With talent so highly regarded and yet so often elusive, business leaders are receptive to both traditional and forward-thinking retention strategies. More than 60 percent of US CEOs said in the 2008 survey that they looked to increased remuneration to attract and retain talent. Nearly as many (57 percent) said that collaborating with networks of external specialists is helpful in correcting shortages in skills and talent.

Concerned that their enterprises are not positioned to leverage human capital, a clear majority of US CEOs were open to reevaluating the way they groom talent. But they were also doubtful that HR is prepared to facilitate needed adjustments. Nearly 60 percent agreed that their organizations needed to change the way they recruit, motivate, and develop people. Yet when asked if the HR function was up to the task of managing any change required to compete for talent, only 40 percent of US business leaders expressed such confidence.

While leadership and employee cultivation are highly regarded attributes, most CEOs said those needs are largely going unmet. A nearly unanimous 98 percent of US CEOs cited the ability to lead and develop others as critical; 66 percent reported difficulty recruiting leaders who can do so. A resounding majority—95 percent—saw investing in training and development as valuable in addressing that gap.

Change: people agenda key to dexterity

The question of change looms large in both sets of respondents, with CEOs worldwide—and particularly those in the United States—viewing change management as a primary component of the people agenda and business success. More than 95 percent of US leaders interviewed for the 2008 survey cited the ability to adjust quickly to internal and external changes as a critical characteristic for their organizations. Globally, 88 percent of CEOs agreed.

Yet organizational reaction to change management falls short, posing a key challenge in light of fast-moving global realities and human capital concerns. The implications for US businesses clearly reinforce the need to fast-track people agenda solutions: Stateside CEOs identified middle managers' lack of engagement or motivation to drive change (61 percent) and senior management's lack of change management skills (54 percent) as critical barriers to success. Lack of collaboration across functions in times of change also concerns US CEOs, with 61 percent identifying such lapses as a critical impediment.

Achieving synergy in transition

In reviewing corporate responses to these changes, business leaders face a substantial disconnect between vision and execution. As previously mentioned, CEOs tended to lack confidence that the HR function is up to the job in terms of winning talent; but most US CEOs (82 percent) agreed that overall, their leadership has the capability and confidence to lead significant change. More than half (54 percent) also reported that management spends adequate time on people issues during times of strategic change. Yet the path to smooth transitions remains littered with human shortcomings, as key personnel matters persistently intrude on efficiency.

In addition to a lack of change management skills among middle and senior management, US CEOs interviewed for the 2008 survey identified a lack of collaboration across functions and internal politics as the most troubling barriers to successful transitions. US leaders also expressed higher levels of concern about people priorities and change, compared with the global sample. Sixty-one percent of US respondents point to poor collaboration as an impediment to seamless transition; and 55 percent point to office politics as an obstacle, while less than half of their global counterparts voice such concern over teamwork (45 percent) and power plays (32 percent).

Leveraging people power: Implications for HR

It is clear that the people agenda is top-of-mind among CEOs, giving HR a unique, unprecedented, and long-overdue opportunity to demonstrate its value to the organization. As business leaders manage challenges and change, growth opportunities, and ever-evolving workforce needs, HR can take advantage of this chance to fulfill its role as a pivotal force in corporate culture.

The people concerns of our CEOs can be categorized under three main HR issues, none of which is new to the HR function but all of which can achieve major improvements with increased levels of HR involvement.

Aligning HR with Business Strategy

Aligning human capital strategy with business strategy is key to driving shareholder value and improving overall business performance. Thus, HR must continue to fight for its seat at the table among corporate leadership—and it must be prepared to deliver. To ensure HR initiatives are aligned with business strategy, organizations must systematically define and measure their workforce investment in order to drive better decision making and management strategies. Evaluating and understanding the needs of the workforce enables organizations to improve overall HR operations, processes, and service delivery while helping the HR function to create alignment among people, program, and organizational development strategies.

And, of course, as the market grows more volatile, financial management becomes a main driver in the overall business strategy. HR has the opportunity to improve return on investment in human capital by enhancing broader human capital capabilities such as succession planning, leadership development, performance management, and cultural transformation—all of which are required to achieve and sustain a competitive advantage.

Managing people and change

HR should take the lead role in managing change—an opportunity that many CEOs see going unfulfilled at present. People issues such as HR strategy, plan design, compliance, and communication are crucial to ensuring a smooth organizational transition.

In today's economic environment, businesses must be agile in order to anticipate change and address it deftly—all the while keeping business on course and employees engaged. Failure to do so can be costly. At the same time, HR's response to today's unprecedented challenges provides a high-profile testing and proving ground. In spite of the complexities, HR has an opportunity to establish an identity as a key ally in the corporate struggle to manage change, minimize risk, and hit the sweet spot between short-term positioning and long-term sustainability.

Winning, developing, and retaining talent

Concerns about the ebb and flow of people who possess critical skills—an issue CEOs perceive as a threat to business growth—point toward an opportunity for HR to deliver the right remedies. For example, creating the right reward plans for employees is essential to attracting and retaining key staff, achieving business and HR objectives, and optimizing related costs. The right reward plan should support the objectives of recruitment, retention, and motivation while achieving the delicate balance between remaining competitive in the marketplace and delivering value to shareholders and other stakeholders.

But reward isn't the only driver for winning and retaining talent. Integrated HR measurement programs provide companies with a means toward evidence-based workforce planning. For example, HR measurement helps companies develop highly defined organizational requirement roadmaps, identify skill requirements and gaps, and create a governance model for data and metrics. Another example includes the implementation of an effective onboarding strategy, which is imperative to retaining new hires once they walk through the door. Training and development coupled with rigorous succession planning can also play key roles in resolving challenges to the people agenda.

Lastly, an effective HR communications strategy can mean the difference between a disgruntled workforce and a satisfied one. Whether sharing information around compensation and benefits, corporate changes, or difficult news such as workforce reductions, a strategic communications program that aligns employee behavior with company objectives is crucial.

Simply put, business success depends on people. The people agenda is irrevocably top-of-mind among our CEOs, and the HR function is finally stepping into the spotlight. This is a crucial time for human capital management. The race will go not to the swift but to the agile. HR can be the differentiator by demonstrating its readiness to lead the charge.



Executive severance arrangements: Competitive practice versus strategic rationale

Scott Olsen, Thomas M. Tabaczynski, and Carl R. Weinberg

No element of executive compensation generates as much shareholder (and media) attention and ire as severance arrangements. This is evidenced in the recent and cynical headlines regarding payouts to CEOs of banks that have failed or are failing, and the positive reaction to institutions that have opted *not* to pay severance to departing CEOs. Fortune 200 proxy statements reveal that most provide these arrangements—in some cases, only for terminations following a change in control; and in other cases, for any not-for-cause termination. The reasons behind executive severance make sense: to attract new executives from the outside, to respond to competitive pressures, to encourage executives to take appropriate risks, and to motivate executives to put shareholder interests ahead of personal interests when considering a transaction.

We agree with the critics—many executive severance arrangements are dysfunctional—but we disagree with their analysis of the problem and their potential solution. Many critics look at the reported value of severance packages and want to either eliminate them entirely or set limits on their value. However, the real problem with current design practice is that compensation committees overrely on competitive practice to guide their decisions instead of applying a strategic rationale. As this article explains, a rules-based approach tailors each executive's potential severance benefit to the strategic situation without creating an additional burden caused by separate negotiations with each individual. We begin the discussion by looking at some of the issues related to severance arrangements.

Reporting the numbers

Executive compensation is heavily reported, but too often the media distort the numbers. This is particularly true when it comes to executive severance packages. The value of a severance package equals the amounts that are *earned* as a result of the termination. Too many reporters confuse the *timing* of payment with the *reason* for payment. As a result, they erroneously include vested elements such as deferred compensation balances, in-the-money value of stock options, restricted stock units that are delivered upon termination, and the value of qualified and nonqualified pension benefits.

To determine whether to include a compensation element in the value of a severance package, a good test is to ask the question: Would the executive receive this amount anyway upon a voluntary termination? If the answer is yes, then it should be excluded from the valuation of a severance package.

Purpose of severance arrangements

Severance arrangements generally serve three purposes: first, they encourage employees to take responsible business risks by providing some personal economic security if those risks do not turn out successfully. Second, they reduce an employee's reluctance to take steps that advance shareholder interests but not the employee's interests. Finally, most responsible employers feel a social responsibility to continue compensating employees during the expected period of unemployment if employees are involuntarily terminated not for cause.

All three purposes apply to executive severance arrangements, and certainly the first two apply more strongly to executives than nonexecutives. Executives have a significant need for these arrangements for various reasons. One reason is that when executives fail, it is usually because they took a reasonable risk that did not work out successfully, not because of a lack of effort or competence. Another reason is that when a senior executive supports—or initiates—a change in control that enhances shareholder value, he or she knows that the other company has another executive in the same role, and chances are only one of them will have a job in the merged company. By denying executives reasonable severance protection, boards—and the shareholders they represent—would encourage risk-averse behavior that may erode shareholder value in the long run.

Common mistakes in designing executive severance programs

When we are asked to review executive severance arrangements, we often see the same mistakes from one company to another. These common mistakes stem from a flawed conceptual approach. Most executive severance programs reflect competitive practice in the company's industry, regardless of what might be necessary to encourage prudent risk-taking and shareholder-oriented decision-making. As a result, some executives are underprotected and many executives are overprotected. No wonder shareholders are up in arms.

Mistake No. 1: Treating all executives in a staff class the same. Many executive severance programs apply a leveling approach, whereby every executive at the same level receives the same benefit. So, the CEO might be eligible for severance benefits equal to, say, three times salary plus bonus, senior vice presidents at two times, and vice presidents at one times. This sounds rational, but it ignores the actual situation. One senior vice president may hold significantly more options than another, due to either a large sign-on grant or an accumulation of awards over several years, and the large potential option gains are often sufficient to encourage shareholder-oriented behavior in the event of a possible transaction. With this in mind, why would this senior vice president also need a large cash severance payment?

Mistake No. 2: Ignoring tenure. We all know that when a senior executive is recruited from the outside, the risk of failure during the first few years is high. The recruiting company needs to provide the prospective executive with adequate protection during the high-risk years. In many cases, without that protection the executive will not join the company. But after a period of three to five years, the executive has a track record of performance within the company, and the risk of executive failure declines significantly. So, if the executive has passed through the high-risk period, why should the severance arrangement remain the same?

Mistake No. 3: Providing the same benefit for external hires and internal promotions. When severance benefits are linked to position level, external hires and internal promotions become eligible for the same benefit, even though the external hire generally faces greater career risk. In addition, internal promotions are likely to have several years' worth of accumulated equity awards, which will help encourage their support of a shareholder-friendly transaction. How does the shareholder benefit from providing the internal promotion with the same severance arrangement as the external hire?

Mistake No. 4: Enhancing change-in-control severance benefits. Many companies enhance executive severance benefits in the event of termination related to a change in control. In these cases, a standard severance benefit of two times base plus bonus might be increased to three times base plus bonus if the termination is related to a change in control. While this approach reflects typical competitive practice, in many cases it squanders shareholder resources. With vesting acceleration of equity, most executives already have sufficient motivation to support a transaction that advances shareholder interests. Why spend additional shareholder funds on enhanced severance that is not necessary to encourage shareholder-oriented executive behavior?

Mistake No. 5: Relaxing performance targets upon a change in control. We are familiar with one chronically underperforming company that granted its equity in the form of performance-based restricted stock. Given the company's performance, several award cycles were unlikely to vest. However, under the terms of the awards, all shares vested immediately upon a change in control. Is it any surprise that the CEO and his executive team went looking for a "white knight" to acquire the company?

Mistake No. 6: Redesigning stock incentive programs without evaluating the potential impact on change-in-control benefits. Companies continue to migrate from time-based vesting of equity awards to performance-based vesting. Based on the PricewaterhouseCoopers 2007 Global Equity Incentives Survey, almost 50 percent of participating companies granted performance-based restricted shares/units in 2007 versus about 33 percent in 2006. We generally support this trend, but it may cause a dramatic increase in the cost of excise tax gross-ups. According to the golden parachute tax rules, when vesting is accelerated on a time-based equity award, only a portion of the award's intrinsic value is counted as a parachute payment. However, when vesting is accelerated on a performance award, the full value of the award is considered a parachute payment. In many cases, this results in a significant increase in the excise tax gross-up. Without sophisticated modeling at the time the design is being formulated, these increases can surprise board members and reduce the portion of the transaction value that is actually realized by shareholders.

Mistake No. 7: Accelerating the vesting of all equity awards upon a change in control. Under the terms of most equity awards, vesting is accelerated upon a change in control. When we ask companies why they do this, they usually reply, “It’s standard practice in our industry.” It might be standard practice (although even that is starting to change), but it may not advance shareholder interests. As an example, we are familiar with a technology company that was recently acquired at a substantial market premium. As is typical for the company’s industry, the executive team held significant numbers of options that vested at closing. The acquirer was interested in the deal only if it could retain the management team, so it negotiated retention bonus arrangements with each senior executive. Those negotiations would not have been necessary if the executives’ unvested equity had “rolled over” into acquirer stock instead of vesting and paying out at closing. Who ended up paying the cost of the retention bonus arrangements? The target company’s shareholders did, because the acquirer negotiated a lower price that reflected the additional cost of the retention program.

A way forward

While we advocate linking executive severance arrangements to strategic rationale instead of competitive practice, we do not suggest a series of individual negotiations with each executive. Instead, we encourage companies to adopt a rules-based approach that results in individually tailored results without individual negotiations. Here are some of the rules we suggest:

Rule No. 1: Use competitive practice as the base case but not as the final result. It might make sense for newly hired executives to be eligible for severance benefits that reflect industry practices. Such executives face greater risk and thus should receive greater protection. But the base level of protection should be adjusted in a prescribed way to reflect relevant individual circumstances.

Rule No. 2: Use rules for adjusting base case severance benefits for specified situations. These adjustments could be up or down depending on the circumstances. The important thing is to develop the rules in advance. For example, an internal promotion from vice president to senior vice president might receive an increase in multiple equal to half the difference in the base case multiples for the two position levels. Alternatively, after every five years of executive service, the individual's severance multiple might be reduced by a half year. We are not advocating for these specific rules; they are illustrations of what the rules might look like. In our experience, the best way to develop useful rules is to follow an iterative process: Test a set of rules by observing their consequences. If the results appear to make sense on an individual executive basis, then chances are they are strategically appropriate rules.

Rule No. 3: Establish an end state. Many executives' severance benefits can be reduced to a minimum level or, in some cases, phased out entirely. The end state can be defined in several different ways—for example, as a certain number of years or a certain level of equity value. But at some point, other programs are accomplishing the original purposes of executive service benefits, and continuation of severance benefits becomes superfluous. As long as executives understand the end state clearly (and it is not immediate), they will be able to plan for it accordingly.

Rule No. 4: Balance the protection of excise tax gross-ups with their costs. There are some good reasons to provide executives with excise tax gross-ups, but the costs can be very high, and they are ultimately borne by the target company's shareholders (through a reduced purchase price). The board should establish rules for determining executive eligibility. For example, since the excess parachute rules often penalize executives who hold on to options instead of exercising them, it might make sense to require a minimum period of executive service before an individual becomes eligible for the tax gross-up.

Rule No. 5: Educate shareholders on the rationale for executive severance arrangements. In the Compensation Discussion and Analysis (CD&A) of the proxy statement, companies are supposed to explain the reasons for all their executive compensation decisions. Yet when it comes to executive severance arrangements, many companies shy away and say very little. As a result, shareholders and potential critics fill the information void with their own explanations. Well-designed executive severance benefits help advance the interests of shareholders. Companies should articulate their reasons strongly—and if they have difficulty developing a compelling rationale, that might be a signal that the program needs revision. Forceful explanations are especially helpful when the company’s severance benefits exceed competitive practice.

Rule No. 6: Disaggregate tally sheets into separate categories for “earned due to separation” and “previously earned and paid at separation.” Tally sheets help the board understand how much money the executives will put in their pockets at the time of separation. However, some of those funds were earned long before termination. Boards need to distinguish between amounts that are earned due to separation and amounts that were earned beforehand but are paid at separation. This will enable the board to make an informed decision about the reasonableness of the severance benefit and the need (if any) to continue compensating the executive during the expected period of unemployment.

When companies designing executive severance arrangements rely exclusively on competitive practice, those arrangements often fail to meet the needs of the executives and shareholders. Companies may find it more effective to use a rules-based approach that stems from the strategic rationale of the severance arrangement. A rules-based approach will allow the company to account for differences in the executives’ circumstances without creating a burden from separate negotiations with each individual. More importantly, the resulting severance arrangements provide executives with the economic security they need to take responsible business risks—without overpaying them in the event of termination.

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Establishing a workforce intelligence center of excellence

Scott Pollak and Michael Tindall

Skills crisis on the horizon?

In PwC's 11th Annual Global CEO survey, 62 percent of the 1,150 executives responding say that they need to change the way they recruit, motivate, and develop employees. Only 43 percent of those same leaders say they believe that their human resources team is adequately prepared to support this change. The global CEO survey further shows that 89 percent of CEOs consider their people agenda as one of their main personal objectives. It's clear that the workforce is foremost in the minds of executive leadership.

Their concerns may be justified, given some eye-opening facts gathered as part of PwC Saratoga's *Human Capital Effectiveness Report 2008/2009*:

- The median organization in the US must annually invest \$0.28 in just compensation and benefits to return \$1 in revenue.
- Nearly a third of newly hired employees do not last a year with the organization.
- The average company has succession candidates for less than 64 percent of its key roles.
- To replace a departed employee, the salary cost of median replacement averages 110 percent of the previous employee's salary.

Good guesses

Executive management often refers to employees as the company's "most valuable asset"—and with good reason. The workforce represents most organizations' single-largest annual investment; the one that can single-handedly control the financial top—and bottom—lines; and the one that directly controls a company's long-term competitiveness through its agility and innovation.

Yet most companies do not have the baseline information they need to make good decisions regarding the workforce. Consider some recent examples: An oil company estimated that it would take six weeks to simply

calculate how many employees it had, and by then the number would have changed. A consumer products company had to establish a four-week project to determine how many salespeople it needed to hire to meet sales projections, and even then the results were at best good guesses. A health insurance company did not recognize that it had two different scales for its annual performance rating: one where a “4” was a “star” performer, and the other where a “4” was likely to be terminated.

Without a handle on even this simplest of information, executives of successful companies readily admit that they got to where they are by making “good guesses” when it came to people-related decisions. The world of good guesses isn’t the platform for building sustained success. Companies that crack the code on maximizing the return on workforce investment will create a sustainable competitive advantage.

In a world constantly pushing for improvement, the information base from which to make decisions on complex workforce issues may decide the winners and the losers. For example, consider whether your company understands:

- Fully loaded cost per employee by role—including direct (compensation and benefits) and indirect (facilities, training, travel, support, tools, etc.)—so that it can make appropriate comparisons to labor alternatives like contractors, off-shore, and outsource options.
- The degree to which performance management and management by objectives programs are (a) being met; (b) driving improved business results; and (c) encouraging appropriate behavior.

The need for information to support decision making has never been more acute, as the workforce finds itself in constant flux:

- On October 16, 2007, Kathleen Casey-Kirschling became the first baby boomer to retire—beginning a wave frequently referred to as the “Silver Tsunami.”

- Younger workers are voicing new priorities. A recent study by Students for Responsible Business found that 82.7 percent of new college graduates surveyed chose an offer from a more “socially responsible” company if the salaries offered were equal, and PwC Saratoga’s recent data suggests that turnover rates are double those of older generations.
- Technology is enabling a more transient and globally diverse employee population, thereby creating a whole new set of management challenges.

The workforce remains at the center of a dramatic disconnect: the asset is demonstrably important, yet its output and return on investment are rarely measured in a systematic, meaningful way. Organizations do not typically possess the information they need to drive more effective and profitable decision-making as it pertains to their employee population.

The obligation to measure the workforce

With only 4 out of 10 CEOs believing that HR is adequately prepared to support change, how does HR fight back from a 57 percent lack-of-confidence vote?

CEOs must task HR professionals with making their contributions more relevant to the current business environment and encourage them to become more innovative in competing for talent and driving organizational change. Companies should expect sustainable, scalable, and immediate sources of information from which to make decisions. Yet this doesn’t exist for the workforce.

Finance, for example, focuses on the inspection and reporting of all financial and fixed assets, while operations implements enterprise resource planning, which commonly measures its production rates, error frequency, the primary causes and results of those errors, and the costs associated with correcting (or preempting) them. In the past two decades, marketing

has turned its focus to scientifically understanding customer profitability and customer behavior. In every case, front and back office functions have learned how to measure performance to make better-informed decisions.

HR, on the other hand, typically does not have this level of focus or measurement—a fact that often causes other functions to question its strategic value and financial relevance. Too often, HR is managed *ad hoc*, with numerous and disparate systems for core employee data, staffing and recruiting processes, benefits and compensation programs, performance, and development. Further, HR is frequently defended as a non-measurable function, better suited to assessment through intuition or “art” rather than consistent analysis or tools. “HR invests in recruiting, compensation plans, and benefits,” the thinking goes, “but not metrics and analytics to improve these processes.” This belief ultimately manifests itself in inconsistent behavior by management and HR, slow response to change, focus on non-value-added activities, and only a reactive response once problems arise.

Consider some statistics from PwC Saratoga’s annual Human Capital Effectiveness webcast the past two years. We asked the attending HR professionals: “How many FTEs [full-time equivalents] do you have dedicated to your Workforce Intelligence Center of Excellence?” In 2007, the 175 attendees answered that 68 percent of the companies have one or fewer FTEs. In 2008 we asked the same question, and the results from the 517 respondents suggested that no appreciable investment had been made, as 69 percent again said one or fewer FTEs. While this survey was not scientific, we believe the results still speak volumes. Without either the resources or investment, HR departments are unable to deliver on this corporate requirement.

To be fair, HR is not entirely to blame: unlike finance, there are no regulatory bodies such as the SEC overseeing HR measurement, nor do HR standards have foundations laid over many decades. Moreover, the responsibility and ownership of these issues require a partnership between executives, line management, and HR.

A function to deliver workforce intelligence

Fortunately, the processes, standards, methodology, tools, and systems do exist for companies to have the information necessary for informed decision making. To pull this all together, however, requires the creation of a function that does not exist in most organizations.

Specifically, organizations can begin to optimize their workforce return on investment through the creation of a Workforce Intelligence Center of Excellence (WICoE), the first step *en route* to a successful establishment of a measurement culture in HR, much as already exists in finance, operations, and other departments. HR must be prepared to step up the level of investment; and executives must demand it. After all, we are suggesting that business leaders make business-changing decisions based on workforce data analysis. To do so, that analysis must be “industrial strength.”

The WICoE will own and govern workforce measurement and analyze the workforce’s impact on the business. It will influence business outcomes by monitoring and identifying solutions to workforce issues across staffing, retention, productivity, development, engagement, compensation, performance, etc. The WICoE will be responsible for developing a distribution channel that most efficiently gets the right workforce information to the right people at the right time and at the right frequency.

Responsibilities of the WICoE include delivering:

Workforce planning—modeling and forecasting workforce and staffing requirements, including roles, locations, and capabilities.

Workforce analytics—*ad hoc* analysis of root cause of workforce issues (e.g., what drives turnover within the high performer population).

Executive and operational workforce dashboards—summary-level, routine reporting of key workforce outcomes.

Standard and ad hoc reporting—routine delivery of workforce outcomes.

Here are some real-world client outcomes stemming from improved workforce measurement:

- A distributor realized that its lack of a scheduling and logistics system was costing it more in turnover and lost sales than the cost of a new system.
- A heavily unionized company recognized it would lose all of its savings attributable to outsource staffing because of a spike in first-year separations.
- A large hospital system was able to improve retention and hiring quality simply by monthly reporting of overall turnover and first-year turnover to each hospital general manager.
- A retailer determined that it would do more to improve customer satisfaction by investing in its employee in-store discount program than in its healthcare plan.

Components of a Workforce Intelligence Center of Excellence

A WICoE organization enables firms to create a methodology for systematically assessing and optimizing key workforce issues such as high performer retention and turnover, leadership effectiveness and sustainability, new hire quality, and career development. With this information, companies can understand where their workforces are most effective, identify tangible opportunities for improvement, and determine which investments are likely to offer the greatest return.

On a surface level, a WICoE can sound deceptively easy. It's why so many finance departments question why HR doesn't simply "get it done." Yet, in reality, establishing a WICoE that gets traction and makes a business impact requires far more than new reports or new tools; it's an organizational design challenge that requires partnership and buy-in from nearly every part of the company; it is a technology and a data challenge that requires transcending the siloed-purchasing, internationally mandated, and M&A-created infrastructure that exists for most; and it is a significant change process for those expected to take action on the information. The complex and lengthy process requires a business case and sizeable investment, and many companies are not yet up to that challenge.

One common misperception is that an effective WICoE is all about technology: put the right technology systems in place, so goes this thinking, and the rest takes care of itself.

Technology is, in fact, critically important to an effective WICoE—but it's also important for a WICoE to establish data credibility by developing processes for cleaning and integrating data and establishing organization-wide standards. It must work to build an organization that is complete with consulting and analytical skill sets not often seen in HR. Lastly, organizations must be committed to developing and cultivating HR and

business professionals who can operationalize the new learnings to the company's advantage. Even the highest-performing sports car does you no good if you don't know how to drive it.

Partnering with an objective and independent human capital expert such as PwC Saratoga can enable companies to implement the right WICoE model for their businesses by establishing appropriate strategies, tools, processes, channels, and benchmarking capabilities.

[A WICoE: Understanding the investment](#)

Consider the ability to understand as much about your workforce as you do about your customers... The ability to unlock the potential of your workforce the way you have with operations... The opportunity to cut costs out of the labor force the way you have cut costs out of your supply chain. Many organizations have focused on these other areas but have not yet focused on the workforce. The results of focusing on the workforce can be as dramatic, if not moreso, given the workforce's ability to innovate and its ability to influence each of the other arenas.

To understand the workforce, companies must house workforce data, performance data, engagement and exit survey data, and business outcome data in the same place. The data must be managed by a department that can operationalize the use of workforce information in business decision making, including internal consultants who can support the existing decision-making infrastructure. This function must be chartered with data governance, defining the single source of the truth and automating the process of “who gets what when.”

It’s exciting to envision the possibilities that come with this information—and the delight of CEOs when their senior HR executives come to them with this level of insight. Imagine the impact of shaving percentage points off the labor cost as a percent of revenue ratio. The downstream impact on income per share is significant. This workforce information gives organizations a powerful platform from which to impact revenue performance.



Rethinking our approach to containing healthcare costs

Michael Thompson

Healthcare costs continue to outpace inflation and have had a significant impact on corporate profitability, hurting our competitiveness on a global scale. In 2007, according to a study by the Kaiser Family Foundation, employer-sponsored health coverage costs rose an average of 6.1 percent against an overall inflation rate of 2.6 percent — *and this was after benefit changes that were generally designed to mitigate ever-rising costs.*

While employers continue to shoulder the largest burden of employee health benefits, the employee's share of healthcare costs has grown proportionately and consistently faster than average wages. In fact, average workers' earnings have grown approximately 23 percent since 2000, while, on average, their contributions for health coverage have more than doubled!

Healthcare costs are the second or third largest business expenditure for most companies, while health reform is one of the top two issues for the American public. Numerous initiatives may be required from a public policy perspective to reduce the number of uninsured; improve transparency, quality, and accountability; as well as revamp our social programs to sustain our health security safety net. However, our success in any of these initiatives is intertwined with our shared need to control runaway health spending.

Examining the past—building toward the future

The recent past has seen a number of waves in efforts to contain healthcare costs. The first was the introduction of managed care, in which health plans attempted to channel patients to preferred providers, negotiate favorable costs with providers, and influence (and in some instances micromanage) providers in an effort to limit over-utilization and reduce variation in care. While having an impact for a number of years, we ultimately hit a wall when people resisted the underlying premise of third-party-imposed limitations on freedom to choose providers or treatment plans. Efforts to reinvigorate these efforts with broader access and pay-for-performance have been slow to impact trend due to the relatively low impact of any single payer or employer on the system itself.

The next wave involved cost-shifting—passing an increasing portion of costs on to employees by imposing larger deductibles and setting increased co-payments while continuing to ask for their fair share of the premium. While cost-shifting continues as a relatively simple solution to mitigate the impact of healthcare costs on businesses, it does little to address the fundamental problem of inexorably rising costs. Furthermore, we have become increasingly aware of potentially negative trade-offs if employees skip needed preventive care, because they perceive it as too costly, which often results in requiring more expensive care later. While increased cost sharing will impact utilization of services, people have a hard time discerning the difference between necessary and unnecessary care, which can have unintended consequences (e.g., lack of adherence to drug regimens). Without controlling the underlying cost increases, we will quickly reach a limit on cost shifting.

A third wave of cost-containment measures was consumer-directed healthcare (CDHC), attempting to take the employer and health plan out of the middle and putting employees in charge of managing their own healthcare dollars. The underlying premise is that knowledgeable consumers aware of their choices will make value-based decisions when it comes to procedures, providers, and treatments. This generally came in the form of a high-deductible health plan and a Health Savings Account or Health Reimbursement Plan together with information, tools, and support to guide those decisions. While some early results have been promising, the uptake has not been as rapid as expected, and the promise of healthcare transformation around the consumer has, at a minimum, been overstated.

The holy grail of “containing healthcare costs” will build on both the successes and failures of the past. The truth is somewhere in the middle, and the solutions will be multifaceted and interconnected.

Simplify the system

Health plans will need to play a role in overseeing and negotiating with the provider networks while adjusting compensation to be more aligned with overall performance. However, the measurement of provider performance will increasingly become a public health issue—representing a synthesis

of community-wide data based on metrics that are defined industry-wide. Investment in infrastructure will be critical to enable more electronic gathering and pooling of data and privacy, and data management will increasingly become more of a public good. Furthermore, many providers are dealing with hundreds of payers with disparate rules and requirements and spending a significant part of their administrative costs, trading phone calls with consumers, employers, and health plans to sort it all out. The system will not fix itself. Industry leadership needs to simplify it all—gradually eliminating these poor quality costs that add little value in the overall health equation.

Shift the focus to health and prevention

Fighting the burden of healthcare may be a losing battle. The harsh reality is that healthcare costs are highly concentrated among a small segment of the population, and this segment is likely to grow. Those costs are necessarily borne by a third party, since very few of us can afford the cost of treatment for major illnesses. Health behaviors are estimated to influence half of our healthcare expenditures. As the American population ages and as our nutrition suffers; as our lifestyles become more sedentary and the business environment more stressful; there's been exponential growth in chronic diseases such as diabetes, asthma, and depression that account for the lions' share of healthcare expenses. Furthermore, studies have shown that the "costs of poor health" are even greater in the form of productivity. As employers increasingly recognize the connection between lifestyle and health and productivity, many are attempting to combat the high costs of treating chronic disease by promoting the health and well-being of their workforces and supporting primary and secondary prevention.

Get the incentives right

Patients and healthcare consumers must be linchpins in health system reform: it will be difficult to impose any system on the American public that does not allow patients to choose the provider or treatment they

feel they need. However, we still want to encourage employees to make value-driven healthcare choices, and those choices are not likely to occur unless patients have a vested interest in being informed and a financial interest in evaluating the trade-offs. Cost *sharing* is not cost *shifting* if it is done consciously to reward the behaviors we seek (both negatively and positively). Transparency of information on health plan and provider performance, as well as relative trade-offs in treatment options, can support a more informed public. And while infrastructure, tools, and support will be required to present that information, incentives will be essential to motivate that public to seek out and act on them. The right incentives are not that straightforward—transparency can be counter-productive if cost sharing causes employees to underutilize needed care—but thoughtful redesign can help us promote the right behaviors. Furthermore, 84 percent of the executives surveyed by the PricewaterhouseCoopers' Health Research Institute believe that the most promising option for keeping corporate healthcare costs manageable lies in providing financial incentives for employees to live healthier lifestyles. Successful programs should tailor incentives to behavior that can be controlled with a clear focus on the ends we are seeking to achieve.

Make it easier to do the “right thing”

No one would argue that making informed choices, particularly in conjunction with one's physician, isn't a good thing. But the evidence suggests that most people don't and won't. We need to leverage the lessons we have learned in other spheres to make it easier for people to make the right choices. The default choice should be the right choice—the high-value choice—the choice that leads to good health. It is unrealistic to assume and expect that all patients will make informed decisions based solely on developing support and providing incentives. Behavioral economists know that certain biases can be and have been leveraged to improve outcomes: the order options are presented, the default if an individual chooses to do nothing, the recommended or convenient choice. We need to make value-based choices toward good health the easy thing to do, whether it is in the design of our programs, the choice of benefits offered, or simply our work environments (try eating healthy out of the vending machine—not the easy thing to do!).

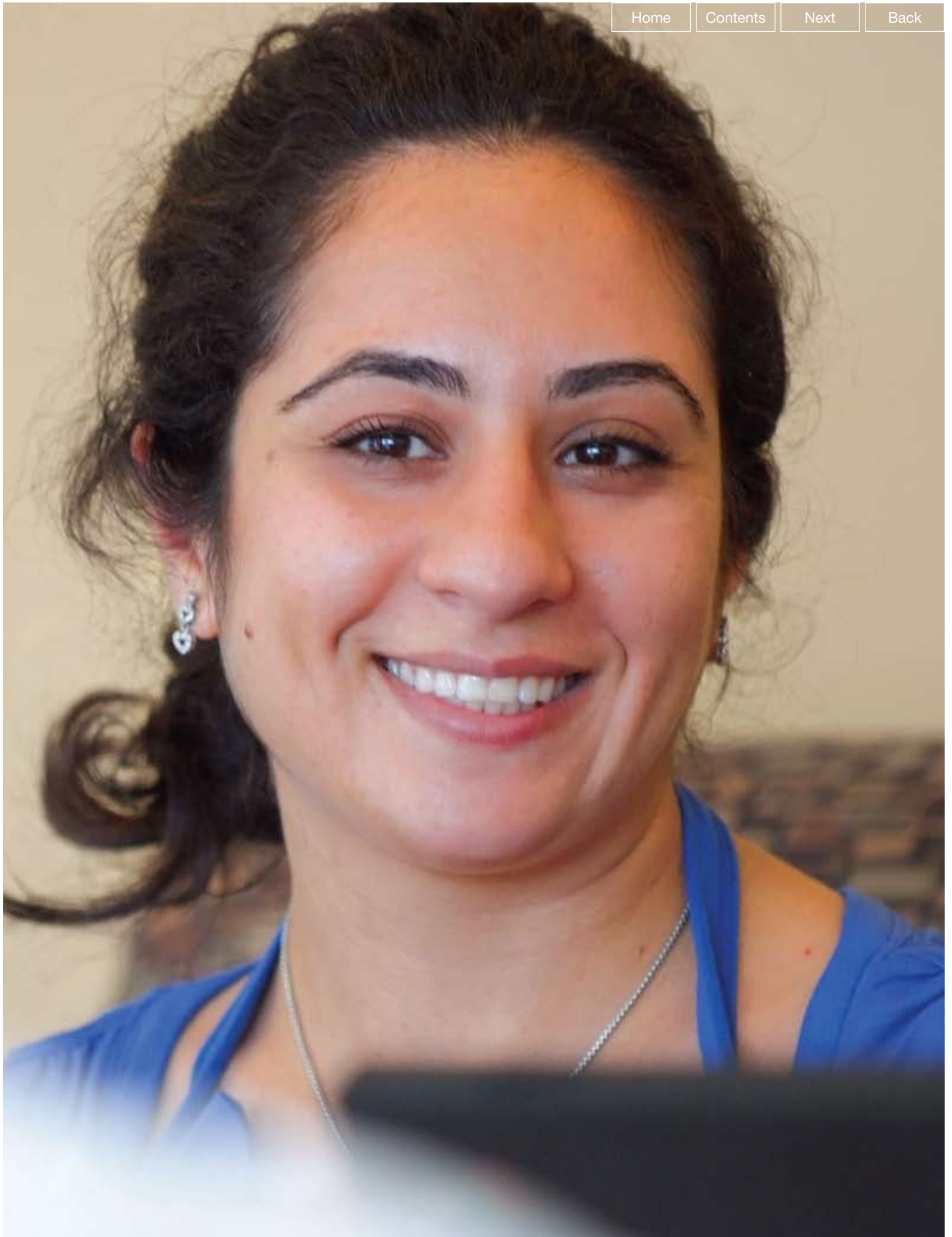
Collaborate to take the longer view

In moving toward a sustainable healthcare system, we need to move away from a mind-set that relies on short-term thinking and lagging indicators. Employers and payers should be looking beyond the short-term and developing a three- to five-year planning horizon, starting with identifying goals, defining budgets, and establishing metrics to assess performance. In addition, as we move to this 21st Century healthcare model, employers increasingly recognize that, for maximum productivity, health must be a core value in companies—a part of the culture. Over time, the work environment must continuously improve in supporting safe, secure, and healthy workplaces and communities. The health of our companies, our economy, and our society is inextricably linked to the health of our people. Achieving this result requires the alignment of health and healthcare efforts as well as the interests of stakeholders across the board, both within and outside our immediate organizations.

Lead the change

To achieve these changes, leadership will be critical. It is not simply a healthcare or human resources issue; it is a leadership issue. Top executives must be involved in making the containment of healthcare costs a core business priority, then seeing to it that plans are created and implemented. We need to foster collaboration and partnerships across internal and external stakeholders as key elements in success. We need to gather the necessary data to evaluate performance and establish metrics to evaluate our progress. Finally, we need to embrace and foster a culture of health and accountability.

We have all contributed to a healthcare system that many now believe is unsustainable. We can and need to build a different system, one that builds on our successes and failures and is uniquely supported by the American culture and infrastructure. The principles outlined here are not new, nor are they prevalent in our health system. If we are successful in achieving sustainable healthcare cost containment, the end result will be beneficial to employers and employees alike, as well as to the health and well-being of our society.



An introduction to plan governance

Charles Yovino and Wendy Vitale

Plan governance in the United States has recently become an increasingly important topic for plan administrators, plan sponsors, and plan fiduciaries. The heightened awareness and interest are attributable to a number of factors, including:

- Evidence that investments in well-governed plans outperform investments in other plans
- The focus that larger plans have placed on corporate governance when evaluating investments, and the lessons they have learned from studying corporate governance
- The exercise undertaken by US public companies to comply with Section 404 of Sarbanes-Oxley and how it has highlighted the lack of control and governance around benefit plans
- A growing focus on plan governance internationally, such as in the United Kingdom, Canada, and the Organization for Economic Co-operation and Development (OECD)
- Lessons learned from recent corporate, governmental, and plan scandals that have increased the amount of attention being paid to the need for improved governance
- Improved awareness that good plan governance is essentially a facet of overall enterprise risk management and builds upon existing control and governance principles that lead to better overall performance and risk management

This article provides an overview of plan governance principles by focusing on three key areas: (1) what plan governance is, (2) why plan sponsors should consider improving governance, and (3) general plan governance standards or principles.

What is plan governance?

Plan governance is the application of traditional corporate governance principles to retirement plans. A concise description of corporate governance is a system or a framework that directs and manages a company through clearly defined roles, responsibility, and accountability. It is sometimes described using military parlance as the “command and control” structure of an organization.

The “command and control” of a plan, however, can be more complicated than a typical corporate structure. The governance structure of a plan doesn’t neatly fit into a conventional organizational chart structure, with a board, subcommittees, senior management, and lieutenants carrying out the corporate goals. Instead, there are often multiple dotted lines reflecting relationships where there is indirect or partial responsibility, and “lieutenants” (who owe their allegiance to the company, not the plan), charged with carrying out the goals of the plan. These conflicts and ambiguous relationships create tensions during the development of a plan’s governance structure. Indeed, because of these tensions, many plans have limited or ill-defined governance in place.

A successful plan governance structure incorporates the principles of good corporate governance with a pragmatic approach that recognizes the unique complexities associated with trying to govern plans. It includes the oversight mechanisms, including the processes, structures, and information used for directing and overseeing all persons who have any responsibilities with respect to a plan. Perhaps the most important facet is that it recognizes, reflects and facilitates the discharge of fiduciary duty.

Accordingly, governance is one of the key tools that can be used by a plan fiduciary to ensure the fiduciary is fulfilling his or her fiduciary obligations. While good governance cannot, in and of itself, guarantee the good performance of a plan, it is a contributing factor to a plan’s success.

The governance structure of a plan doesn’t neatly fit into a conventional organizational chart structure... Instead, there are often multiple dotted lines reflecting relationships where there is indirect or partial responsibility.

Good governance demands clear accountability for every decision made with respect to a retirement plan. Such accountability leads to better plan administration.

Why improve governance?

Effective plan governance is an essential element in the prudent and proper functioning of retirement plans. Generally, good governance promotes the timely and cost-effective delivery of benefits and promotes the administration of the plan in the best interests of the plan members and beneficiaries. Good governance requires the appropriate control mechanisms that encourage good decision making, proper and timely execution, and regular review and assessment. Additionally, strong governance reduces potential liability for the plan sponsor, the administrator, and associated advisors. Good governance demands clear accountability for every decision made with respect to a retirement plan. Such accountability leads to better plan administration.

In addition, the recent wave of business scandals and ethical lapses, as well as the large number of under-funded plans being foisted on the government and on taxpayers have heightened public, press, and investor scrutiny of companies, demanding a corporate culture of integrity-driven performance and greater corporate transparency. Management and Boards now feel compelled to ensure that proper governance processes are in place to protect corporate reputation, brand image, and shareholder value. Important purposes for establishing a proper plan governance approach are to protect the corporate reputation and image, to ensure the financial viability of the plan, and to enhance the value of plan assets and thereby protect shareholder value.

A number of published studies have also established a correlation in defined benefit plans between better plan governance and improved investment results. In the defined benefit plan context, this is important for employers, since improved investment results will lead to reduced contributions and expense. If the premise that better-governed plans have better investment results can be extrapolated to defined contribution plans, then plan fiduciaries of poorly governed defined contribution plans may be at risk for the lost return. Similarly, if they are not exercising adequate oversight of service providers and plan expenses, they could be causing the plan to overpay for these services. Again, the result would be lost return for the plan participants and possible exposure for the plan fiduciaries. The proposed rules issued by the Internal Revenue Service and the Department of Labor in 2007 requiring greater transparency of plan fees and expenses will only sharpen the focus on these issues.

Best practices in governance

Best practices are the means by which leading companies have achieved top performance. They serve as goals for other companies striving for excellence. Best practices are not the definitive answer to a business problem but should serve as a source of creative insight for business process improvement. Best practices for plan governance consider all facets of plans, such as funding, investment, benefits administration, and risk management.

Governance models vary from one company and one industry to another, though successful systems share a number of common characteristics.

Included among those common characteristics are the following simple principles, which are the foundation for good plan governance.

- Establishment of plan mission and objectives
- Defining clear roles, responsibility, and accountability
- Risk management
- Transparency and disclosure
- Clear performance measures
- Adequate knowledge and skill sets
- Oversight and compliance
- Establishment of a plan level code of conduct and a policy to address conflicts of interest
- Succession planning
- Fiduciary duty
- Periodic self-assessment

These principles, discussed in detail later, lead to the sound administration of plans, as well as the proper handling of funding and investments. These principles apply to all types and sizes of plans. While the application of these principles is essential to achieving effective governance, there can be many methods for implementing them.

1. Establishment of plan mission and objectives

The plan sponsor, administrator, and fiduciaries should begin by establishing a plan mission that briefly describes the plan's overall goals and purpose. Although the plan's mission might initially seem obvious (*e.g.*, to provide for retirement benefits), the mission should provide insight into how the plan will provide retirement benefits. Where will the plan stand philosophically on the following questions?

- Will the emphasis be on providing participant education on investing and saving?
- Will there be a focus on managing cost? (This could require a simpler plan, more indexed funds, and a lower level of service from the administrator.)
- Is the plan a differentiator in the market? Is it intended to help attract and retain personnel?
- How important is risk management? (This can impact both the investments in the plan and the vendors selected.)

The mission statement, if properly crafted, can provide guidance for all the decisions that are made relating to the plan. It provides the compass that keeps all the players facing in the same direction, with the same ultimate goals.

Equally important are the objectives that the plan sponsor, administrator, and fiduciaries are responsible for achieving. The objectives should be clear, documented, and communicated to all the parties involved in plan administration (as well as to plan participants). The objectives provide the framework for the administration, management, and overall oversight of the plan. Objectives should be set for the plan as a whole and should target specific activities within the plan.

The mission statement... provides the compass that keeps all the players facing in the same direction, with the same ultimate goals.

For the plan sponsor, administrator and fiduciaries, the objectives should be established strategically (e.g., identify the transactional risk associated with the plan, and establish a control framework to manage the risk). The “lieutenants” or managers responsible for execution should look to plan objectives for guidance in establishing priorities. These objectives should be reviewed when performing self-assessments to determine the effectiveness of the plan’s governance and the success of its operations.

2. Defining clear roles, responsibility, and accountability

The plan’s administrators should define the roles and responsibilities of each person or entity involved in the management and operations of the plan. The governance structure should make it clear who is responsible for overseeing that certain tasks or functions are accomplished and who is accountable for completing those tasks or functions. Effective supervision is possible only if management has clear instructions from the plan administrator or fiduciaries regarding management’s specific responsibilities, and the responsibilities of subordinates. Also, managers must fully understand their roles in terms of expected results and policies to be followed. Roles should be defined in terms of both specific actions and expected outcomes so that the people in the roles can make adjustments to their actions if adjustments are needed to achieve the desired outcome. These specified actions should be included in those individuals’ performance measures so that they will be rewarded when desired outcomes are achieved. Additionally, the plan’s administrators should clearly identify the stakeholders to whom each entity or individual is accountable. This way, all will know what is expected of them and who will be confirming that they meet those expectations.

Good governance demands clear accountability for every decision made with respect to a plan. Accountability leads to better plan administration. While responsibilities can be delegated to committees and personnel both internal and external, accountability for direction setting and supervision cannot be delegated. The chain of delegation should be documented, and performance objectives and reporting relationships established between the roles. Accountability for selecting delegates and for monitoring the actions of delegates should be clear. Individuals who delegate tasks still maintain accountability for the role leading to the requirement for oversight of delegated duties.

The roles and responsibilities of each employee involved in the oversight or administration process of the plan should be clearly defined in a written document. This will allow for the continuation of roles after the employees who are currently in these positions change employment. Without written documentation covering these roles, their continuation depends on word of mouth and may change depending on the interests of the new employees. Also, the written document should be distributed to each employee involved in the oversight or administration process of the plans so that they will be aware of them.

3. Risk management

The plan administrator or plan fiduciaries should establish an internal control framework, appropriate for the plan's circumstances, that focuses on the plan's potential risks. Control activities should exist to ensure all plan activities receive proper review and that necessary actions are taken to address and mitigate any potential risks. Control activities have various objectives and are applied at different organizational levels. Separate control activities should be in place that relate to both plan policies and plan financial information. Once the control activities have been established, those individuals who will be accountable for the findings of the control procedures should be included in the monitoring of these activities.

The administrator, acting in its fiduciary capacity, should understand and approve the framework as well as the written internal control procedures supporting the framework. Internal control procedures should identify responsibilities and accountabilities; set out the process for recommending, approving, and implementing decisions; prescribe the frequency and format of reporting; confirm that funds are being managed prudently; verify that plan provisions are being interpreted consistently and benefits paid correctly; and address policies on funding, investing, expense management documentation, recordkeeping, benefit administration compliance, outsourcing, and communication. Exceptions, such as those arising where plan provisions are not clear or where there is room for some discretion, should be reviewed and approved by the plan administrator.

4. Transparency and full disclosure

Transparency of information about existing conditions, decisions, and actions is integrally related to accountability. Accountability is enhanced through disclosure and transparency. Accountability is the responsibility for specified activities after the action has occurred, while transparency relates to disclosing details of specified activities before or during the time they occur. These are similar, though they differ in the timing of the disclosure and therefore the ability to alter the future implications of the actions in question.

The plan administrator should provide for communication of the governance process, of the objectives, and of other items to plan members, beneficiaries, and other stakeholders to facilitate transparency and accountability. Responsibilities of each participant in the governance, management, and operation of the plan should be clearly communicated to that party as well as to other parties involved in the process. Board and committee members should receive reports on the activities of those people to whom they delegate any responsibility.

There is no requirement to provide detailed information on the governance process for plan participants. Transparency can simply mean a high-level overview of how a plan is managed. The intention is to provide a comfort level that the plan is being properly managed. This may require some high-level, basic information about the governance process. Most members want to know about benefit entitlements and investment returns. Detailed governance information is not as important to the average member. Most members want to know only that there is a good governance process in place; they are not concerned with the details.

The plan administrator and fiduciaries should have responsible and capable parties available to address member inquiries and be able to handle any complaints through a conflict resolution process. The steps involved in this process should be clearly defined for participants so that if they should have a complaint, they will know the proper procedure to have it addressed. Generally, this process is included in the summary plan description sent to each participant.

Transparency of information about existing conditions, decisions, and actions is integrally related to accountability. Accountability is enhanced through disclosure and transparency.

5. Clear performance measures

The plan's administrator and fiduciaries should provide for the creation of performance measures for monitoring the performance of individuals and entities involved in the plan's administration and investments. Performance in all plan activities, including pension administration and funding status as well as investments, should be measured against predefined goals and adjusted for differing needs over time. Performance objectives and measures should be tailored to each plan's specific requirements. Results should be reported to the appropriate stakeholders. Measuring performance facilitates separation of the supervision of operations from their execution.

These measures should be set for all parties with responsibilities related to the plan. This includes internal and external parties. The administrator and the plan sponsor should expect and look for an acceptable level of professional conduct and advice from the plan trustees, managers, and advisors, and if the conduct is not appropriate, the administrator should determine what follow-up action is necessary—including the use of professional disciplinary procedures and legal recourse—and proceed as the situation demands.

These measures should be established in advance of the measurement period and be communicated to all the parties being assessed. If all parties know what is expected of them, they have a much better chance of meeting these expectations. Defining and communicating the performance objectives will substantially increase the likelihood of having these goals met.

It is important to make sure the performance measurements are understandable to each person involved in the process. Performance measures should be "SMART" goals. The characteristics of SMART performance measures are:

- **Specific:** clearly identifiable, should be obvious not just what actions are to be performed but also what results are to be achieved
- **Measurable:** performance is quantifiable
- **Accountable:** who, specifically, is accountable for what
- **Realistic:** should focus on objectives of the plan and be of a scope and scale that could be achieved by the individual
- **Timely:** a specific target date for achieving each goal should be agreed upon

Finally, the issue of goal setting must be addressed at different levels within a retirement plan. Each manager must be given objectives specific to that manager's role.

Performance in all plan activities...
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over time.

6. Adequate knowledge and skill sets

The plan administrator and fiduciaries should establish an ongoing process to identify the knowledge and skills needed for the effective governance of the plan. Each person involved in plan administration should have, or be expected to acquire, the knowledge and skills that are current and appropriate for the responsibilities and accountabilities they carry. The plan administrator should develop a process to address any gaps in knowledge and skills through training or ongoing education.

Administrators who accept the oversight role must have the experience and qualities necessary to oversee a complex financial endeavor. In many instances, the plan administrators and fiduciaries may find their plan duties require skills or knowledge that are broader in scope than their normal duties. While there is no explicit curriculum that needs to be studied in order to be a steward of retirement plans, prudence demands that administrators or fiduciaries have a minimum level of understanding in areas where they will be making decisions, such as financial markets, risk management, and vendor management. Plan administrators and fiduciaries must also be prepared to study and understand the terms and policies of the plans.

The challenges facing the administrator of a plan require the application of a broad range of skills and knowledge. The administrator may acquire skills and knowledge by employing qualified staff (plan managers) or through outsourcing. Selection of staff and/or agents and monitoring of the delegated work are the responsibilities of the party who commissions the tasks. In addition, the administrator must assess the quality of the services or advice and decide whether to accept the services or follow the advice. The administrator and the fiduciaries need to have sufficient knowledge and skill to assess the quality of services and advice provided by professional advisors. The administrator and the fiduciaries must have a reasonable understanding of the issues to assess the credibility of the advisors and the rationale behind their recommendations.

7. Oversight and compliance

Plan administrators are not required to devote their full time and attention to the plan's affairs. They may delegate some or all of their responsibility for plan administration to a committee, which in turn may assign this authority to a senior officer(s), who in turn may assign it to a more junior officer or to an external agent. Accountability is not transferred by such delegation,

and thus a supervisory process should be in place. The plan administrator is expected to oversee the business and affairs of the plan but is not expected to manage the plan on a day-to-day basis. Delegation should be made to a group of managers who are responsible to and report to (whether directly or indirectly) the plan administrator or committee on a regular basis.

The work being delegated should be performed conscientiously and with a focus on quality by those people to whom the work is being delegated. Several of the aforementioned principles help to ensure quality and diligence in performance of assigned duties. Clear performance objectives and clearly defined roles help in the understanding of job duties. Accountability and strong internal controls help to ensure no one in the plan administration is working contrary to the plan objectives. These principles in action along with knowledgeable and skilled employees should ensure work related to the plan is being performed with due diligence and at acceptable quality levels.

To oversee the operation of the plan, the plan administrator and fiduciaries need sufficient and timely information about financial and administrative performance. In their supervisory roles, the administrator and fiduciaries should perform the following tasks to properly supervise plan operations: assess periodically whether objectives of the plan are being met; ensure absence of (potential) conflicts of interest; ensure controls are in place and that they are audited regularly; set expectations with management and evaluate performance through effective delegation where required; consider the necessary resources required to pursue the objectives and strategies; review correspondence relating to the plan to assess specific administration matters; maintain appropriate records of key meetings and decisions affecting the plan; and confirm follow-up action.

Plan administrators may delegate some or all of their responsibility. Accountability is not transferred by such delegation, and thus a supervisory process should be in place.

The plan administrator should establish appropriate mechanisms to facilitate oversight and ensure compliance with legislative and regulatory requirements, as well as plan documents and policies. The plan administrator should identify the legislative and regulatory requirements and the documents and policies that apply to the plan. The plan administrator should put in place a mechanism to ensure compliance with the legislative and regulatory requirements and the plan documents and policies. Often, this task is delegated to a member of the legal department, though ultimate accountability rests with the plan administrator or fiduciaries.

8. Establishment of a plan level code of conduct and a policy to address conflicts of interest

A code of conduct that applies to corporations or boards of directors should be different than a code of conduct designed for plan administrators and fiduciaries due to different roles and responsibilities. A plan level code of conduct—including conflict of interest policies and procedures that set out the required behavior for the plan administrator, fiduciaries, and their delegates—should be clearly articulated and monitored. This code should cover benefits administration and funding, as well as investments. Potential conflicts between plan roles and corporate roles should be recognized. Examples of such conflicts should be spelled out so there is no confusion on the parts of those acting on behalf of the plans. If there is any question about whether a conflict exists, the individual with the conflict should have access to an independent advisor. The code should address actual and perceived conflicts of interest of the plan administrator, fiduciaries, and their delegates and provide a dispute resolution mechanism when conflicts arise.

To meet the fiduciary duties required of plan administrators and fiduciaries, employees are sometimes forced to place the interests of the participants above the interests of the company. Administrators and fiduciaries must understand what conflicts of interest they may face and commit to resolve them in favor of the plan's beneficiaries. It is important for those employees

to have a special code of conduct to follow in these circumstances. An appropriate code of conduct specific to the governance objectives adopted by the plan administrators should be published and made available to those acting on behalf of the plan.

9. Succession planning

Succession planning is important whenever continuity is critical. Just as it is important in maintaining corporate governance, it is important for plan governance. A procedure or process should exist for selecting members of the governing body, for setting their term, and for their removal. It is knowledgeable and competent employees with a clear understanding of their roles and a strong commitment to carrying out those roles that make the governance structures and policies—as well as overall plan operations—work in practice. Succession planning for these individuals is vital to the long-term success of the plan. Without it, good governance may be only temporary. Consequently, succession planning should be established and reviewed regularly, and it should be part of the long-term governance objectives of the plan.

10. Fiduciary duty

One of the most basic foundations of a plan governance process is that the process must recognize fiduciary duties and make it as easy as possible for employees to fulfill their fiduciary duties. A fiduciary has the power and discretion to unilaterally affect the plan beneficiaries' interests. The plan administrators have a duty to interpret the plan terms fairly and pay the benefits promised. Clearly, the plan member is vulnerable to the fiduciaries' decisions and actions, giving rise to the need for duty, care, and prudence. The greater the discretionary powers of the administrator and fiduciaries, the greater is the scope of fiduciary duties. The terms of the plan design are frequently set unilaterally by the plan sponsor, but they must be interpreted impartially, fairly, and in good faith when paying the benefit promised. Plan

fiduciaries must always act in the best interests of beneficiaries, impartially treating members with loyalty and without personal profit.

Fiduciary obligations normally extend to and include ensuring the completeness of plan terms, complying with legislative requirements, communicating to members their rights and entitlements, ensuring actuarial valuations are performed for defined benefit plans, ensuring required contributions are remitted to the plan at the correct times, ensuring funds are invested with prudence, and ensuring payment of benefits is correct, timely, and in accordance with plan terms and the law. The plan administrator and fiduciaries must make sure that their fiduciary responsibilities have been fulfilled through judicious advice and recommendations. In these actions, the plan administrator and fiduciaries should be extremely conscientious in considering the interests of the plan beneficiaries. They should also be aware of their fiduciary responsibilities and the standard of care required when considering what to disclose, the manner and form of disclosure, and whom to inform.

One of the most basic foundations of a plan governance process is that the process must recognize fiduciary duties.

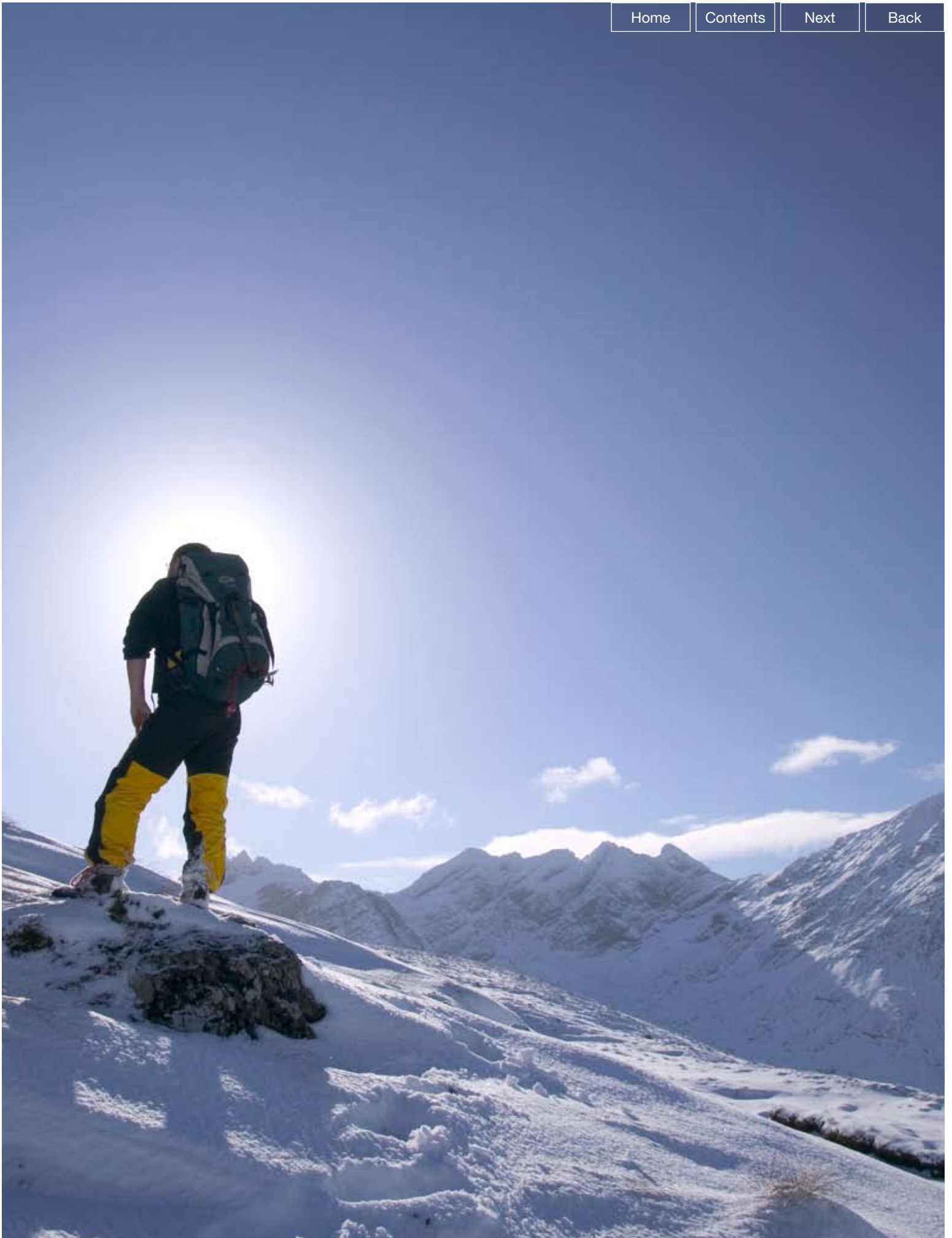
11. Periodic self-assessment

Governance should be reviewed continuously to meet emerging challenges. Some form of governance evaluation is essential for plan administrators in understanding the governance risks they and their plans face, and where improvements are required. The plan administrator should establish a process for the regular review of the plan's governance. This may be accomplished through a self-assessment process, which can involve the assistance of third-parties (e.g., internal audit or outside

advisors). Self-assessment offers an opportunity for plan sponsors to share the responsibility for benefit delivery with the other stakeholders. The governance process should be reviewed and modified periodically to ensure its effectiveness. The plan administrator should put in place an effective process to address any problems or inconsistencies found concerning the plan's governance process. The objective of the assessment should be to determine the effectiveness of the plan's governance structure and operations.

With the increasing scrutiny on plan operations and performance, plan governance is more important than ever, and the principles outlined in this article provide a good basis to begin developing a strong plan governance structure. Maintaining effective plan governance is essential to the proper functioning of retirement plans and promotes the timely and cost-effective delivery of benefits. Considering the growing volatility in today's marketplace and the recent wave of heightened public, press, and investor scrutiny, companies are being held to higher standards of integrity-driven performance and increased corporate transparency. Now is the time to ensure that proper governance processes are in place to protect corporate reputation, brand image, and shareholder value.

Governance should be reviewed continuously to meet emerging challenges.



Retirement benefits for the globally mobile employee

Cindy Fratterigo, Eileen Mullaney, and Ann O'Connell

The notion of being sent on assignment overseas sounds exciting. Going abroad is a tremendous learning opportunity for an employee, from both a professional and personal standpoint. Unfortunately, it is not always without financial consequences to the assignee. In fact, a long-term assignment can have a detrimental effect on the employee's retirement benefits.

Simply put, the vast differences among laws and regulations in various countries frequently cause both US and non-US assignees to lose pension benefits.

As multinational companies continue to stretch their borders and expand their globally mobile workforce, awareness of the adverse effects on one's retirement plan is growing. Many key executives are even declining foreign assignments as a result. Unfortunately, an executive's expertise is very valuable and often necessary to help foreign offices succeed, and this unwillingness to take on an assignment can ultimately affect a company's bottom line.

In addition to those who are now declining international assignments, there are also those already on assignment who are demanding that their pension benefits be evaluated and "fixed" by their companies.

The changing definition of employee mobility

An international assignment can no longer be viewed as a limited period with a clear beginning and end. Because of the increased need for employees to go on assignment, coupled with the increased value of an experienced assignee, companies are often sending capable employees from one assignment to the next, "wherever duty calls." This group of truly mobile employees, some of whom can be considered lifetime assignees, has been integral in the redefinition of what constitutes an assignment.

More and more individuals are being asked to take on multiple, back-to-back assignments in different countries where the tax and benefit laws vary, further complicating the issue of pension planning.

The changing structure of pension planning for mobile employees

Oftentimes, assignees' retirement plans are frozen while they are on assignment, and upon return, the retirement plans would "pick up where they left off." During the assignment period, the assignees (1) may be able to participate in the host country plans, or (2) may lose all opportunities to earn retirement benefits, or (3) may defer income while on assignment.

It is often the older, experienced workforce that companies are trying to send on assignment—a workforce population that is obviously more concerned with their retirement. In the past, when learning about potential changes to retirement packages, assignees showed less concern because they were traditionally younger and there was a clear beginning and end to an assignment. Now, it's the older workforce that we are trying to move—and move more frequently. Therefore they are much more apt to resist any changes to their retirement plans. The younger staff can be easily motivated to take on a three- to five-year assignment based on the compensation offer, but the experienced workforce is looking at the whole package. When approaching the higher paid, more experienced executives for whom retirement isn't far off, the offer needs to be better.

Even assignees covered by local plans during the assignment may suffer due to the extent that the local plan does not offer similar benefits (defined contribution versus defined benefit, for example), offer as rich a benefit, credit non-local service toward accruals or vesting, or result in a tax-effective accrual or distribution. As the assignment period grows longer and the differences in benefit plans and tax rules across various countries grow more complex, companies cannot simply "make up" the lost benefit upon the assignee's return to the home country plan because of plan or tax authority limitations.

These new mobility trends create the need for new pension designs. Trying to make the assignees whole by providing local plans simply won't work in most cases because eligibility and coverage issues differ from one country to the next.

Inventing unique plans to address assignee pensions

To address the issue, some companies have revisited their expatriate benefit packages, taking a more detailed look at the retirement benefit opportunities available. This has resulted in fresh, innovative plan designs that meet the companies' unique needs. For example, a company may create different assignment programs for different levels of employees. This approach can be compared to the "frequent flier" concept that was adopted by airline companies—awarding the highest volume customers with top-tier or "elite" membership rewards (free upgrades, unlimited access to elite airport lounge, preboarding, etc.), followed by mid-level "preferred" membership awards (low-cost upgrades, passes to the airport lounge) and lower-level rewards to average customers, and so on.

In other words, a company may provide its top assignees with a premier program that includes all the bells and whistles, such as additional housing allowances, tuition for children's schooling, a flat dollar amount to account for spending differences between the home country and the country of assignment, and an 'umbrella' defined benefit retirement plan in which the benefit is 50 percent of final pay, offset by pensions accrued in each local country plan. The same company may provide a more limited program with a defined contribution plan that has various levels of contributions that correspond with the rank of its other globally mobile employees.

Additional examples of how companies have created new plans to give incentive to potential assignees can be found in the case studies at the end of this article.

How did we get here?

Some of the key macro global trends that have led to the reexamination of retirement program design are:

- Increasing mergers, acquisitions, spin-offs, and corporate restructurings
- Closing existing pension plans to new entrants and/or freezing accruals (US, UK, Europe)
- Establishing defined contribution plans (US, Canada, UK)
- Increasing legal requirements to provide defined benefit plans upon retirement (Asia)
- Changes in laws and treaties that affect the cost, reporting requirements, and tax treatment of benefit plans

Necessary steps toward improving pensions for assignees

1. Assess the company's corporate growth strategy, and review the need for expatriates by taking a closer look at the existing expat policy to facilitate that strategy. Determine how pensions fit into the overall assignment package. Before jumping into the development of international pension plans, evaluate whether or not an assignee can remain in the home plan. If not, a company should then consider: (1) What is the company's international growth strategy? (2) Is there something in place that protects the plan? (3) If the assignee can't stay in the home plan, what other options are there? For instance, instead of doing international assignments, do you just assign someone as a local hire? For example, one PwC client has greatly reduced its number of international assignees by putting a training program in place for local hires. One person is deployed to train a team so the company can utilize local talent rather than sending existing talent overseas.

2. Be cautious when developing an alternative offer. There needs to be a well-designed selection criteria in order to determine who will be eligible for a comprehensive, international pension plan. The alternative plan should not become a “catch-all” or you may end up with a much larger number of people enrolled than originally anticipated (and budgeted for).

Before developing a global pension strategy, multinational companies need to ask themselves whether the mobile employees can remain in their home country’s pension plans, as this is often the best approach for all parties. Alternatively, companies need to know whether host country pension plans are available to mobile employees, and if they are, whether they adequately cover globally mobile employees. Lastly, in host countries where local benefits are available, companies should explore whether social benefits are available or mandated, whether there are “length of stay” requirements for assignees to receive pension benefits, what the penalties for noncompliance are, and what other tax and legal requirements exist.

If a company determines that local host country pension plans are not adequate and the existing home country plans are neither available nor tax efficient, the company may need to establish a separate plan to cover the assignees. In this case, the company needs to decide the optimal plan structure to meet its objectives. Initial guiding principles for determining the plan structure include the delivery model (defined benefit or defined contribution), whether or not the plan should be funded or unfunded, and what the benefit levels will be. The company will also need to evaluate local plan administration, assess vendors and distribution alternatives, identify potential tax consequences, and finally, properly transition to the new plan. Although stated simply enough, this undertaking is far from simple.

There's still a long way to go

As previously mentioned, more and more highly qualified senior executives who, for example, are about 15 years from retirement, are wisely saying “no” to international assignment requests. This is not because they do not want to go on assignment—they know the value they can provide for their foreign operations—but because they will lose too much of their pension benefits for the period of time they are away. Other employees are finding it may be too late to make up for the loss they suffered while on previous assignments. Employees who fulfilled an assignment for 10 years are only now realizing how much in pension benefits they forfeited over the course of those 10 years. Employers are realizing the consequences of loss in talent when key employees decline to take international assignments because of pension concerns.

The following table illustrates how an assignment could affect the lifetime annuity (under a basic defined benefit plan and a typical defined contribution plan) of an assignee who is not eligible to continue earning benefits under the plan while on assignment for 3, 5, and 10 years.

Percent reduction in ultimate benefit level	Years on assignment with no benefit accrual		
	3	5	10
Defined benefit	-9%	-14%	-29%
Defined contribution			
Age at leave			
35	-9%	-16%	-31%
45	-9%	-14%	-28%
55	-8%	-13%	-25%

Approaching the issue

The need to accommodate transfers and career expatriates requires attention to retirement planning as a part of a company's global HR framework. Development of a retirement program encompasses analysis of program design alternatives, costs, tax impact, as well as planning for administration and communications. The process should be undertaken in three phases:

Phase 1: Plan Design

Activities include:

- Determination of plan design objectives
- Analysis of plan design alternatives
- Review of administration requirements
- Discussion of currency and tax considerations

Phase 2: Plan and Process Construction

Activities include:

- Analysis of impact of plan design for key countries
- Validation of administrative processes
- Assessment of tax implications of program (during accrual and payout)

Phase 3: Plan Rollout

Activities include:

- Development of plan documents, trust, and employee communications materials
- Implementation of employees' elections and payroll deductions
- Design of ongoing reporting functionality

Program design considerations

Plan design	Defined Benefit or Defined Contribution
Funding	Assets contributed to a trust or an unfunded promise to pay
Offsets	Should the benefits be reduced by amounts accrued in currently provided arrangements?
Eligibility	Select individuals versus all mobile employees
Payment options	Annuities, lump sums, etc.
Currency considerations	On accrual and pay out
Employee communications and elections	Type and format that will be used
Other	Tax and reporting compliance, financial reporting impact, administration

There is no one simple solution to addressing diminution of retirement income for international assignees and their resulting reluctance to take on overseas assignments. There are many complex considerations that must be explored at the outset of developing a global pensions strategy that makes the most sense for a company. Some of those considerations were touched on earlier to begin the thought process on how a company might tackle the issue. Another great way to evaluate approach is to review what other companies have done, and whether or not something similar might work for your organization. Whatever the approach, a solid global retirement strategy that meets the needs of the globally mobile workforce is essential.

George Burns once joked, “Retirement at 65 is ridiculous. When I was 65 I still had pimples.” That is not a commonly shared sentiment. It is important for companies to acknowledge that retirement is top-of-mind among employees today, and a pension plan is not something they are willing to sacrifice for the good of the company.

Case study one:

Faced with inadequate retirement benefits for employees who accepted multiple international assignments, this company needed a plan that supported international mobility, as well as one that aligned with its corporate culture—a culture that is very paternalistic. The company still offers a rich defined benefit plan to its US employees, and it was looking to mirror this benefits structure when developing a plan for its mobile workforce.

Due to the large number of individuals currently on, and expected to go on, assignment and the related costs of the program, the company decided to establish strict guidelines around eligibility for the benefit plan. Assignees had to:

- Be full-time employees, age 55, with 10 years of service
- Retire from a non-US based business unit (because they otherwise put assignees back in the US plan if retired from the US)
- Be approved by the plan's Administrative Committee (Those with self-initiated transfer requests and localizations were not eligible to participate.)

The company decided to establish an international benefit plan covering eligible assignees. To limit “double dipping” and to reduce costs, benefits from the international retirement plan are offset by the amount of any retirement plan payments to which the company contributed during the participant's career. As was intended, the benefit formula is similar to the existing US plan. There are no employee contributions. Assignees are 100 percent vested at age 55 with 10 years of service. Normal retirement age is 65 with five years of service. Assignees may choose from five annuity distribution alternatives. Assignee tax treatment depends upon country of citizenship, countries of employment during the assignee's career, and the country of residence upon receipt of benefits.

With careful planning, this company was able to extend its tradition of providing its employees with a rich retirement benefit to its increased global workforce—an important characteristic of the corporate culture and loyalty that is highly valued among its employees.

Case study two:

Tax effectiveness was a tremendous driver behind the international plan design that would become part of this company's "Total Rewards" strategy. Effectiveness being top priority, it was important to devise a plan that would not become labor intensive to administer.

Prior to developing a new international plan, this company was already mirroring today's trend by beginning to transition from defined benefit to cash balance or defined contribution arrangements. The company wanted to follow similar principles when developing a plan for its mobile workforce, aligning the program with business priorities and corporate culture, while remaining sensitive to the international nature of the intended participants.

The company decided to adopt a hybrid program: half of which included an unfunded retirement plan that is not taxable in most countries and otherwise protected from double taxation, and half of which included a savings plan that is not tax deductible (in most cases) but if an assignee saves a certain percentage of pay, the company provides a 150 percent match in the retirement plan—providing a strong, employee-driven incentive for the assignee to save while overseas. The plan also included an international life insurance and disability program.

This tax-efficient alternative plan design proved to be appealing to the international workforce while supporting the overall goals of the business.

Case study three:

This company wanted to make sure that retirement benefits for its employees who met the criteria of "top management" would be protected. The company was very happy with its existing plan in the US and wanted a simplified approach to the international plan that would provide similar benefits.

International assignments are career drivers for top management in this organization. In fact, the leadership development mobility program is a highly selective talent management initiative that is intended to provide high performers with appropriate global experiences that help to advance their careers within the organization. It was important that the mobility program be valued as a retention tool; therefore they couldn't afford to have a poor pensions program leaving a sour taste in the mouths of participants.

Ultimately, the company wanted to develop a simplified, cost-effective plan with administrative ease. The company wanted this select group of top management to receive similar benefits compared to what they would receive in the US plan or, even better, benefits. Because of the career driving element, the international plan ended up providing richer benefits than the US plan. It allowed for "double dipping" of benefits (in matching and profit sharing) for participants working in countries with other required benefit plans, and participants were grossed up on the pension accruals if there was tax on deferral to ensure they felt truly rewarded. Lastly, the company agreed to keep the plan unfunded and pay benefits when due to participants—charging back to the host country at time of accrual (*i.e.*, annually).

The delivery structure of the program is as follows:

- Current US 401(k) plan is the model
- Employee deferrals with a dollar-for-dollar match, up to 5 percent (base and bonus)
- Discretionary profit-sharing contribution based on the company's corporate performance
- Notional interest rate based on Moody's +1 percent.
- Catch-up contributions allowed

There is immediate vesting of all contributions. For distributions, the retiree receives a lump sum upon termination, retirement, death, or disability, and the distribution may require a six-month deferral. The administration is outsourced and the employee has online access to his or her "notional" account balance throughout the year. The program has proven to be successful in supporting the company's overall talent management initiative.



Retiree healthcare: A strategy for success

This article also appeared in *Growing Your Business*, Volume 58, 2008

Theresa Gee and Martin Hill

Retiree healthcare is one of the top 10 healthcare issues facing executives and policy makers in 2009, according to PricewaterhouseCoopers' Health Research Institute. Older employees worry that healthcare after retirement will be at best unaffordable and at worst unavailable. Most executives agree that employers should help provide access to affordable retiree health benefits, but they no longer want to be expected to pay for them. As the cost of healthcare continues to increase and as access to coverage wanes, a new approach is needed—and ever more urgently as the baby boomers head toward retirement.

Cause for concern

While Medicare provides at least partial health benefits for retirees age 65 or older, “more than three million retirees between the ages of 55 and 64 rely on employer-sponsored plans for their health insurance coverage... and more than a third of all people aged 65+ (about 11 million seniors) have supplemental coverage from an employer plan.”¹ Without those employer-sponsored retiree medical benefits, older employees may have difficulty finding affordable retiree medical coverage on their own, particularly prior to their eligibility for Medicare. According to Michael Thompson, a principal in PricewaterhouseCoopers' Human Resource Services practice, “If a group of pre-65 retirees does not get coverage from employers and goes on the open market for individual health coverage, only about one-third of the group will be quoted standard rates; another third will be quoted higher rates; and the final third may not get any coverage at all, primarily because of pre-existing medical conditions.”

The days of promises to cover “retiree healthcare for life” are over. However, abandoning retiree healthcare benefits entirely may not be in your company's best interests. These benefits can be critical to hiring and sustaining the right mix of talent. Here is an approach to retiree healthcare based on four key principles that can help you achieve these goals without impacting your financial statements.

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Henry J. Kaiser Family Foundation, “*The State of Retiree Health Benefits: Historical Trends and Future Uncertainties*,” Patricia Neuman, Sc.D., 2004.

To make matters worse, many individuals nearing retirement are inadequately prepared for and unaware of the issues they will face around their health security. Medicare remains the cornerstone of health security for most retirees, yet according to its Trustees, it is projected to be insolvent in about one decade unless there is serious intervention.

At the same time, the percentage of companies with more than 200 workers that offer retiree coverage dropped from 66 percent in 1988 to 33 percent by 2007, according to the annual Kaiser/HRET Employer Health Benefits Survey. And smaller companies are even less likely to offer retiree health benefits.

Access to healthcare during retirement also affects an employee's decision to leave or re-enter the workforce. Many employees who would like to either retire or begin phasing into retirement are remaining at work full-time simply to retain employer-provided health benefits. "For example, a 60-year-old person with Type 2 diabetes can't afford to retire; he or she runs the risk of not passing a medical exam," according to Martin Hill, a director and actuary with PricewaterhouseCoopers' Human Resource Services practice. "Over time, this can create a stagnating older workforce, which makes it difficult to ensure the right mix of talent and, importantly, to recruit advanced hires."

Limit costs or optimize talent pools?

Not surprisingly, employers are increasingly unable or unwilling to incur a retiree health expense and liability that cannot be sufficiently controlled. Companies that have provided retiree health benefits have begun to cap or eliminate those benefits, particularly for new hires.

Accounting rules have played a role in this shift. "Companies have reacted to the negative—and often hefty—impact of FAS 106 accounting for post-retirement health liabilities on their financial statements," says Hill. "They have responded by continuously shifting more of the cost of retiree health coverage to their retirees. For some, it's a simple matter of accurate reporting under GAAP [generally accepted accounting principles]. For

others, it's the reputation of retiree medical plans—they've heard the horror stories about the crippling costs of retiree health and are hesitant to get in the game themselves.”

At the same time, attracting talent remains a top concern. “Some mid-career individuals will not accept a position unless they can be sure they can retire with adequate access to health benefits,” says Thompson, “and this will become an increasingly high-profile issue. Ten years ago, many companies were seeking to move toward a younger workforce. Now, companies are competing for an inadequate pool of seasoned employees. With 25 percent of the workforce approaching retirement age, that shortage will only increase, and companies will need to find ways to attract and retain experienced talent. Providing retiree access to affordable health benefits provides a valued and valuable benefit and competitive advantage.”

A new paradigm

Clearly, companies need to rethink how they approach retiree healthcare. Companies will need to devise a strategy that addresses the health security needs of retirees while retaining their ability to control costs and manage their talent pools. A successful approach to retiree healthcare can be built upon the following four principles:

- Ensure access and choice
- Integrate health security into retirement education and financial planning
- Consider integrating account-based defined contribution plans
- Enable stewardship of benefits

Ensure access and choice

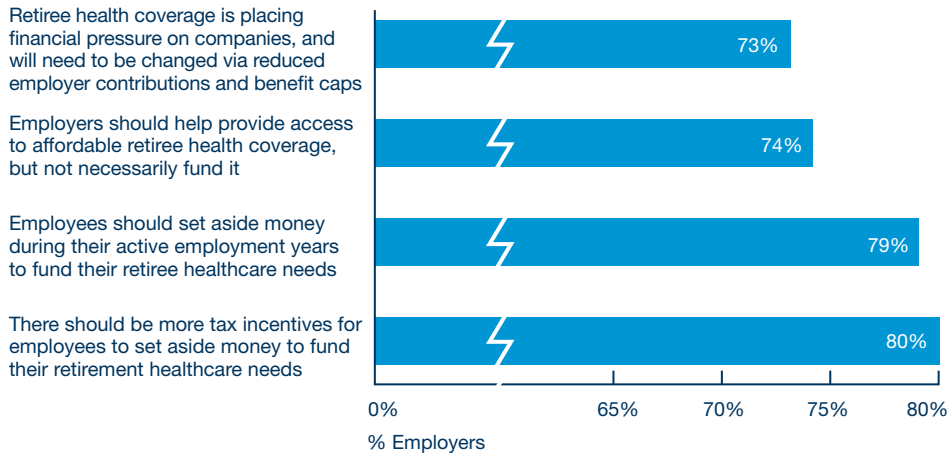
In a 2007 PricewaterhouseCoopers survey of executives' views on retiree health coverage, 73 percent of respondents said that the coverage places financial pressure on companies, and that it will need to be changed via reduced employer contributions and benefit caps.

However, while employers want to get out—or stay out—of the healthcare business, they don’t want to walk away from the issue entirely. In another 2007 PricewaterhouseCoopers survey, employers showed strong support for assisting employees in managing their own retiree health and associated costs, with nearly 80 percent in support of providing savings account mechanisms, tax incentives, and access to coverage even if they do not fund it. (See Figure 1.) And, in a climate that focuses increasingly on wellness, employers want to encourage active employees to “invest” now in their futures via healthy lifestyle changes and sound financial decisions for retiree health coverage.

Thus, even as retirees assume more of the financial burden of coverage, a company can play a major role in facilitating access to coverage upon retirement as well as through second careers and phased retirement. To that end, companies should offer a range of choices to support various degrees of affordability and coverage.

Figure 1: Employer views on retiree health

In describing your views about retiree health coverage, do you agree at least somewhat with the following statements?



Source: PricewaterhouseCoopers 2007 Management Barometer Survey

Educate employees

Generally speaking, employees do not appreciate the scope of the issues and financial needs related to retiree medical benefits. For example, workers typically do not realize how expensive retirement healthcare can be, particularly when one considers coverage before Medicare eligibility and the need for coverage for the rest of one's life. Employees also do not save enough for retirement in general, and specifically not enough to provide adequate health coverage; financial planning tools rarely fully acknowledge the significant role of health expenditures during the retirement years. Numerous studies show that, given inadequate savings rates, Americans “will not be able to support a moderate lifestyle in their retirement years, let alone out-of-pocket healthcare costs and premiums... Some employees are retiring before they are eligible for Medicare, which requires even more savings.”² Moreover, lengthening lifespans mean an even bigger strain on inadequate savings.

Integrating health security education with general financial security education can be critical to the long-term well-being of employees. In addition, employees need the tools to make informed choices both while active and once retired. For example, retirees “need support comparable to what they were accustomed to receiving through a benefits representative. This practice will ensure that retirees use their contributions/accounts efficiently and are getting the coverage that meets their healthcare needs.”³

Consider account-based defined contribution plans

The shift toward employee responsibility and away from company sponsorship can be viewed as analogous to the shift from company-sponsored retirement plans to individually-managed 401(k) and 403(b) plans. Employers can similarly consider the use of defined contribution account structures—for example, Health Savings Accounts, VEBA's, and notional Retirement Health Accounts—to assist retirees with their long-term health security needs.

² “New Models for Retiree Healthcare,” National Business Group on Health, 2007.

³ Ibid.

“Funding for retiree medical is always a challenge because there is no perfect account structure for tax-advantaged savings for retiree medical,” says Hill. “Each type of account structure has pros and cons. However, employers can examine strategies that utilize and potentially combine both funded and non-funded account structures.” Integrating traditional and non-traditional account structures for the retiree provides more predictability to the employer while enabling active retirees to visibly understand, assess, and “own” their retiree health security issues. (See Figure 2.) Says Thompson, “As you think through what account structure will work for your company, you will need to determine how best to support employees in preparing for their retirement health security.”

Figure 2: Comparing approaches to retiree healthcare

Element	Traditional/defined benefit approach	Access only/defined contribution approach
Liability	Employer obligation with uncontrollable liability	No or defined employer obligation
Responsibility	Primarily company (little “employee ownership”)	Employee or employer/employee shared responsibility
Level of employee involvement	Minimal employee knowledge and engagement	Engaged and educated employee
Employee appreciation of benefit	Generally not considered part of “total rewards”	Considered as part of “total rewards”

Enable stewardship of the benefits

One of the keys to designing an effective strategy for retiree healthcare is to recognize the need for a longer time horizon, both because people may not be able to retire for many years and because the healthcare landscape will continue to change dramatically. We know Medicare can't stay the way it is. Moreover, companies themselves change, sometimes dramatically through mergers and acquisitions or industry restructurings, and some even go out of business. As Thompson points out, "Who will keep track of the healthcare environment as it evolves? How will you keep your options current over time? Whatever strategy you put in place for today must be adaptable to changes that will occur tomorrow."

As a result, it can be helpful to engage a third party to steward and effectively update the program over time. Says Thompson, "Stewardship can optimize the choice and value of the retiree medical benefits over time and preserve the value of the benefits or funds that may have been accumulated over time."

Looking forward

As the cost of providing retiree health benefits continues to grow, providing affordable access to healthcare for older employees becomes more important for employers—and for their employees. By building a strategy based on the aforementioned principles, you can limit your financial exposure as an employer while still providing a valued benefit for older workers. In an environment of escalating costs and an unpredictable future, providing affordable healthcare access along with the right employee education can help you attract and retain valuable talent—and protect your bottom line.



Keeping fit and flexible: A view from abroad

As a global economic downturn begins to bite, HR has a critical role to play in ensuring that their organization is in a strong and agile position for the future

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After a long period of growth, the current economic climate is undeniably volatile. The financial market crisis of the past 12 months is now feeding into a more widespread downturn and recession in many geographic markets. The turbulence and emerging global recession is forcing companies to scrutinize costs more closely than ever. These stark economic times remind us very forcibly that flexibility is critical to sustaining business strategy and responding to market changes.

To survive and succeed through this downturn, human resources (HR) must help the board identify what their business and employees should do differently to ensure they are in a strong and agile position for the future—simple job and cost cuts now are not enough to thrive, nor do they create a platform for the future upturn.

As the downturn deepens, cash-strapped companies may feel pressure to reduce headcount, but this can be a costly exercise in itself—both in terms of payments as people leave, and recruitment costs when the market picks up.

While making redundancies will be unavoidable for some, there are significant potential savings to be made in managing people costs more efficiently and in deploying and rewarding employees more creatively (and if the worst happens—in dealing with redundancy payments).

At PwC we've identified 12 primary 'people cost' areas that companies should assess and take decisive action on. These are: pensions; headcount; absence management; expenses; use of contractors; analytics and benchmarking; pay and productivity; incentives; employee benefits; secondments and mobility; flexible working; and HR and finance effectiveness.

A critical first step for businesses is to identify the talent that they cannot afford to lose—top performers are even more in demand when times are tough. Ensuring the right reward structures are in place for employees when costs are being cut and incentive pools are down will keep the right people

in the business. To support this, regular communication with employees will help to reinforce their commitment and increase retention both now and when the upturn begins (for however bleak it may look today, the upturn will surely come).

Efficiency in costs such as share incentive programs, sickness pay, other employee benefits, and company car schemes are often overlooked and represent opportunities for quick wins to ease the hit to the P&L account.

The pension scheme can also be a significant financial burden and drain not only on current cash but on your balance sheet; however, there are many ways to reduce this cash commitment, eliminate volatility, and clean the balance sheet.

During these turbulent times, it is important to make decisions quickly. HR must understand the financial case for change and react swiftly to deal with the needs of the business. Even more focus comes on metrics and flexibility. A creative approach to solving these problems is needed and commercial advantage can be gained—advantage that will feed through to the future health of organizations.

For example, the manufacturing industry has taken the lead in offering reduced salaries or introducing a shorter working week in order to save jobs. Other sectors have focused on redeploying people to those parts of the business that continue to thrive during the downturn. We are also seeing changes to benefit structures to drive down expense and a true flexibility on variable pay to eliminate “wasted” incentives.

The message is clear—businesses in all sectors must consider different ways to reward and deploy their staff to minimize the long-term impact of this downturn. This means HR must ask some challenging questions of itself and of CEOs as they reach for the tired old solutions that have been used in the past. Cutting training to nothing, for example, does not help build a robust and sustainable business; while killing the international

assignment program will only serve to prevent businesses from moving people into the more robust geographic markets.

If companies harness the flexibility and creativity needed to minimize employment costs while keeping employees engaged, the end of this downturn could look very different with businesses much better placed to build back up quickly and exploit the upturn.

Now is the time to ask difficult questions and tackle the elephant in the room. All organizations should be striving for agility and the current economic climate makes that need all the more pressing. Every crisis, remember, presents its own opportunities.

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About Human Resource Services

As a leading provider of HR advisory services, PricewaterhouseCoopers (PwC) brings together a broad range of professionals working in the human resource service arena—compensation, benefits, retirement, HR strategy, international assignment, regulatory compliance, tax, process management, culture and change, communications and financial planning—affording our clients a tremendous breadth and depth of expertise, both locally and globally.

PwC's Human Resource Services (HRS) practice assists clients in improving the performance of all aspects of Human Capital and the HR organization through technical excellence, thought leadership and innovation around four core business issues: Financial Management, Risk Management and Compliance, Operational Excellence and Transaction Effectiveness.

Our expertise in tax, accounting, actuarial, finance, operations and compliance; our leadership in human capital management, measurement and program development; and our disciplined approach to execution and change sets us apart. With more than 6,000 HRS practitioners in offices across 100 countries, PwC helps to align human capital strategies with business strategies and drive shareholder value for our clients.

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