HR innovation

Winter 2014

04

ACA ins and outs for employers and the global workforce

12

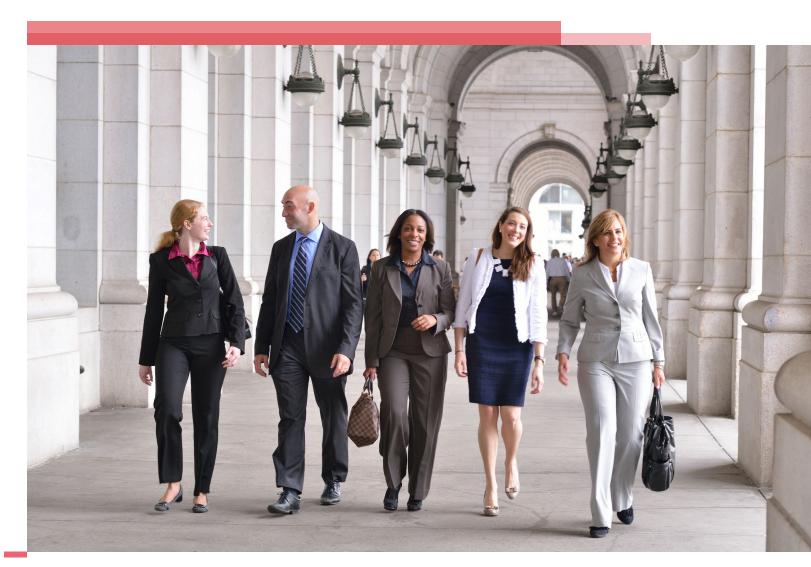
Are your non-US retirement funds under the FATCA microscope?

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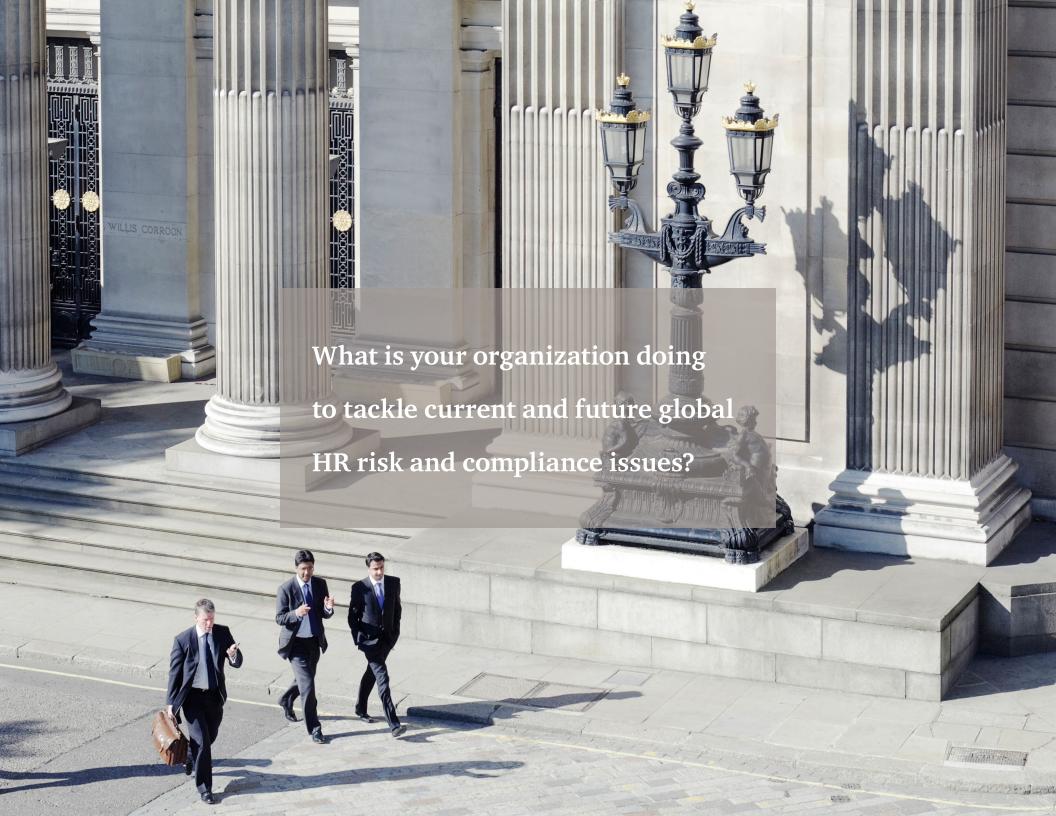
Is your M&A sending top talent into a tailspin?

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Improve and streamline global performance:
The power of governance, risk, and compliance to corral chaos







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Foreword

What is your organization doing to tackle current and future global HR risk and compliance issues? The winter of 2014 seems destined to be characterized by a strange combination of major winter storms and a severe drought, depending on where you sit in the United States. Business leaders can be excused if this onslaught renders some familiar concerns about risk and uncertainty. As businesses still struggle toward recovery, regulatory and growth challenges are continually evolving, intense, and tightly wound. There is a prevailing sense of "only time will tell" sensibility. And yet, strategy, execution, and compliance decisions require action today.

Healthcare and related wellness issues remain front and center for the public, the media, and employers and employees alike. The Affordable Care Act (ACA) continues to present myriad challenges in its complexity to numerous overlapping stakeholders, some of which transcend the borders of the United States. We

have identified some novel issues with regard to the Act's implications for organizations and their global workers—issues that may have escaped notice amid the ACA's massive domestic implications. Find out how you can protect your entity and valued workers from ACA missteps and costly penalties.

Similarly, some executives might be surprised to learn that their overseas retirement funds might be subject to The Foreign Account Tax Compliance Act (FATCA). We'll delve into the daunting realities, discuss how this may affect your operations, and give you some tips to prepare your organization to cope effectively.

Doing deals? In going after M&A value, do you risk alienating and losing key talent? We've found that's a risk that many organizations fail to face up to. Talent retention issues can be avoided with some careful

strategic pre-planning. We'll highlight some practices that can seal in value as you seal the deal.

Finally, amid all this change in its many variations, we'll show you ways to safeguard your integrity and enterprise by scrupulously applying the principles of governance, risk, and compliance (GRC) across the HR function.

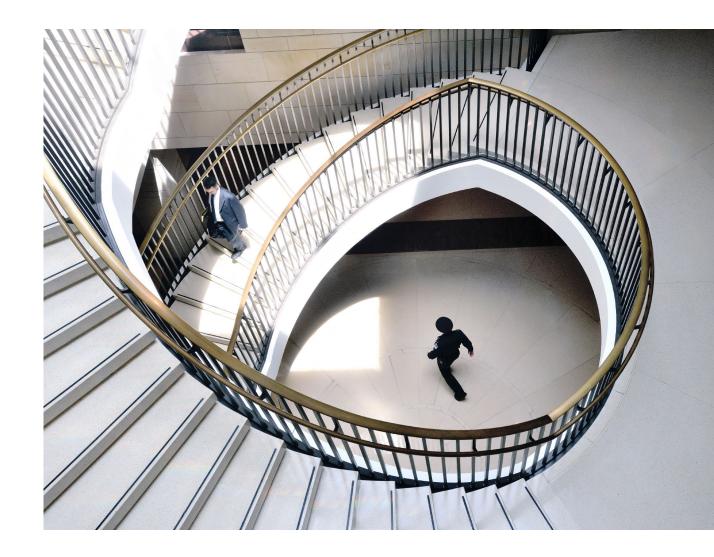
Read on to build your awareness and knowledge on these matters in the following articles:

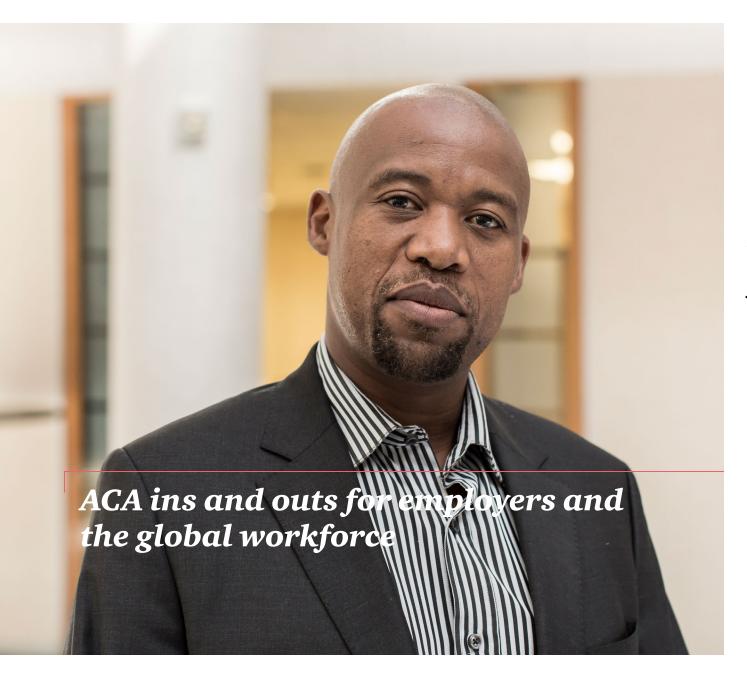
- ACA ins and outs for employers and the global workforce
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- Improve and streamline global performance: The power of governance, risk, and compliance to corral chaos

The following pages share some high-level insights into some of the most challenging risk and compliance issues facing leaders now, as well as action steps that can position your organization to weather the storm in 2014—and the years that follow. I hope you'll find value in these pages and find yourself poised to set sail into a tumultuous year and to see it through with increased confidence and solid strategies.

Scott Olsen

US Leader, Human Resource Services





By Amy Bergner and Birgit Anne Waidmann

As the Affordable Care Act (ACA) comes into greater focus, we see a number of implications for a growing list of stakeholders—and not only in the United States. Employers have long been challenged to provide meaningful healthcare coverage to a globally mobile workforce. Today, the changing US healthcare landscape presents vexing new hurdles. Individuals and employers are—or will be subject to new mandates, while insurance products and the channels for purchasing them are in an intense state of flux.

Employers with globally mobile employees face key questions relating to long- and short-term assignees:

- How the individual mandate impacts US outbounds and inbounds
- The status of insurance and other health coverage under the US law
- How employer obligations under the ACA will affect the company and its globally mobile employees

Both employers and assignees must comply with the ACA's many diverse requirements, and corporate teams responsible for ACA compliance must take into account the globally mobile workforce in their implementation plans. Vendors providing health coverage or ancillary benefits will also be affected.

An ACA primer

US healthcare reform under the ACA aims to broaden the availability of health insurance coverage through mandates on individuals and

employers and new public exchanges, or market places, where individuals and small businesses can buy coverage.

Starting in 2014, most US citizens and resident aliens must have coverage each month or face potential tax penalties¹, an imperative known as the individual mandate. To satisfy the mandate, individuals must have "minimum essential coverage" (MEC), which includes:

- Individual insurance purchased in the United States on a state exchange or from a state-licensed insurer
- Employer-provided coverage (either under an insurance policy or self-insured)
- Medicare, Medicaid, or other governmental coverage
- Coverage under an insured expatriate policy that is limited to primary insureds who are expected to reside outside of their home country for at least six months of the plan year, and any covered dependents, at least through 2016

- Foreign government-provided health insurance that obtains approval as MEC from the US Department of Health and Human Services
- US citizens living abroad for a calendar year or for at least 330 days within a 12-month period (who are eligible for the foreign earned income exclusion under Code section 911) are treated as having MEC.

Beginning in 2015, employers with 50 or more full-time workers² (including US subsidiaries of foreign parent companies) must offer certain health coverage to their full-time employees or pay penalties. Group health plans offered to employees must comply with a variety of benefit mandates, and the plans and employers will have US tax reporting obligations. Because benefit design and administration for many inbound companies reside in the home country, it will take special efforts to attend to these US mandates.

Starting in 2014, most

US citizens and resident
aliens must have coverage
each month or face
potential tax penalties.¹

Most individuals will avoid tax penalties if they have a gap in coverage of three calendar months or less.

A new transition rule increases this to 100 or more for 2015 only.

ACA and globally mobile individuals

To help illustrate the impact of ACA on globally mobile individuals, let's consider several examples.

Example 1. Al, a US citizen, works for Smart Company in Asia during 2014 and 2015. He has a tax home in Singapore and is eligible for the US foreign income tax exclusion. Al is deemed to have MEC, whether or not he has health insurance in Asia, so he is exempt from individual mandate penalties.

Example 2. Renee, a French citizen, works for Smart Company in New York City for two months in 2014. Renee is a non-resident alien, and is not subject to the individual mandate.

Example 3. Zhang, a US resident alien, works in the US for Talent Company from January through December of 2014. Zhang must maintain MEC or could face US tax penalties. Talent Company offers Zhang coverage under its self-insured health plan for US employees; this constitutes MEC.

Example 4. Gunther, a US resident alien, works in the US for Green, Inc., a German company, during 2014. Green Company provides health insurance for Gunther under an expatriate insurance policy issued in Germany. Gunther will be treated as having MEC for 2014.

Example 5. Sally, a US citizen, works for Green, Inc. in Germany during seven months in 2014. Sally is not eligible for the US foreign earned income tax exclusion. Green, Inc. provides Sally with an expatriate insurance policy issued in Germany. Sally will be treated as having MEC for 2014.

Example 6. Nora, a US citizen, works for Green, Inc. in Germany for four months in 2014. Nora is not eligible for the US foreign earned income tax exclusion. Green, Inc. provides Nora with coverage under a US business travel insurance policy. Nora probably does not have MEC and could be subject to a penalty.

While these examples may seem fairly straightforward, a careful look beneath the surface reveals

some nuances that may need further analysis. For example:

Al may not know at the beginning of 2015 whether he will qualify for the foreign income exclusion. If Al assumes he will qualify and doesn't have MEC, but circumstances change so that he won't qualify for the foreign income exclusion, he could be hit with penalties. The most cautious approach for Al and Smart Company may be to make sure he has MEC in the event that he doesn't ultimately qualify for the income exclusion.

Renee is a frequent business traveler and must exercise caution if she begins to spend more time in the United States. Once she is deemed to be a resident alien, she would be required to have MEC. Smart Company may wish to cover Renee under a plan for expatriates during her time away from France, if it is expected that she may spend at least six months of the year away from home.

Talent Company could run into problems if its European parent is unaware that the ACA applies to its inbound employees and to the US subsidiary, and if the US subsidiary is unaware that its inbound employees must be considered as it implements the law. If Talent Company doesn't offer the right kind of insurance to its inbound employees, the employees could incur penalties for not having MEC. Failure to account for inbound employees could also trigger penalties for Talent Company, a point we'll elaborate on later.

Green, Inc.'s complex global mobility situation creates risk for individuals, the company, and its US subsidiary. For example, outbound employees might receive healthcare coverage under a local foreign plan during the time they reside in Europe, yet they and their families must carry MEC or possibly face penalties. Green, Inc.'s HR and benefits staff should assess whether the coverage it offers to the outbound group (and family members) will qualify as MEC, and be sure to include full-time outbound employees as they assess employer obligations. And, like Talent Company, Green, Inc. must carefully

Foreign-regulated insurance

US regulators have confirmed that group insurance regulated by a foreign government (e.g., home country insurance, such as an insured group policy issued in Ireland) will be treated as MEC for a month covering an individual who is physically absent from the United States on at least one day during the month. Foreign-regulated insurance that covers US-provided health benefits for expats physically present in the United States for an entire month is also treated as MEC. In either case, the plan sponsor—typically the employer—must provide a specific notice to enrollees who are US citizens or nationals and must also comply with US income tax reporting requirements.

Any employer with 50 or more full-time equivalent employees in the United States is potentially subject to the ACA's employer mandate.

analyze its inbound employee population to be sure that these employees have MEC and that they do not trigger penalties for the company based on its US operations.

ACA's impact on employers with globally mobile workforces

Any employer with 50 or more full-time equivalent employees in the United States is potentially subject to the ACA's employer mandate. The count of full-time equivalent employees is based on employees during the previous calendar year. Our experiences with several global employers illustrate some traps for the unwary in assessing whether they must comply with the employer mandate. A couple of examples will help illustrate this.

In 2015, Gamma Corporation has two full-time US citizen employees and 50 part-time US citizen employees. (Based on all the hours they worked, they sum up to 32 full-time

equivalent employees.) In addition, five non-resident aliens work full-time in the United States.

The company also has 3,000 US citizens working only outside the US; their hours don't count toward determining whether Gamma is subject to the employer mandate because work that is not compensated by "US source income" isn't counted in determining whether an employer has 50 or more full-time equivalent employees.

All told, in 2015 Gamma
Corporation has 3,057 employees
globally, but has only 39 full-time
equivalent employees with US
source income who must be counted.
Gamma Corporation will not be
subject to the employer mandate
for 2016 because it has fewer than
50 qualifying full-time equivalent
employees in 2015.

In 2015, Belgium-based Sigma Corporation has 14 US citizens and five L1 visa employees paying tax in the United States as full-time workers. Sigma also has 48 part-time workers (32 full-time equivalents) in the United States. In total, Sigma has 67 employees with US source income and 51 full-time equivalent employees, so it is subject to the employer mandate for 2016.

In comparing Gamma and Sigma, this outcome may seem anomalous, as Gamma Corporation, with many more employees than Sigma, is not subject to the employer mandate while Sigma is subject to the mandate.

Requirement to offer coverage to 95% of full-time employees

Once an employer knows that it will be subject to the employer mandate, it must assess and later report to the IRS whether it offers coverage to 95%³ of its full-time employees. If not, it must pay a penalty of \$2,000 multiplied by the number of its full-time employees (with the allowance to subtract 30 employees⁴).

For this purpose, full-time employees are generally those working 30 hours or more per week, counting hours for which the employee receives US source income. The penalty is assessed monthly for each month for which coverage is not offered as required. Because this penalty can rise to significant levels very quickly and isn't linked to whether full-time employees actually have coverage, employers will need to carefully assess their full-time employee population and health benefits plan design.

The employer mandate is slated to start in 2015, but employers need to pay attention to this requirement now, particularly if they have employees who are not routinely working 30 hours a week during the year. Under complex rules, employers with variable hour, part-time, or seasonal employees need to determine whether individuals must be treated as full-time employees, even if they don't fall into the traditional "full-time" employee definition.

Employers most impacted by these rules include those in the retail, hospitality, education, amusement, and healthcare sectors. But with changes in the workforce, almost all employers must assess whether they have individuals who will trip the "full-time" employee trigger. This entails setting up a period to count hours (a measurement period) and treating employees averaging 30 or more hours a week as full-time during a subsequent "stability" period.

Employers with a globally mobile workforce should be aware of these potential pitfalls:

 US citizens who work outside of the country but who are ineligible for the foreign income exclusion or who receive US source income must be counted (if working on average more than 30 hours per week) as full-time employees in the employer shared responsibility test.

- Inbound employees working in the United States (permanent residents, resident aliens, and non-resident aliens) must also be counted in the employer shared responsibility test if they are working on average more than 30 hours per week. Employers must offer coverage to foreign employees working in the United States and to their dependents, if these employees are full-time employees, based on the hours of service for which they receive US source income.
- Workers considered common law employees under US law must be taken into consideration; foreign definitions of common law employment won't govern this determination.
- The determination of whether an employer meets or fails the 95% test is made for each "member" (typically an entity with a separate US tax employer identification number) of an employer's

The employer mandate is slated to start in 2015.

^{3 70%} for 2015 only, pursuant to transition rules.

^{4 80} for 2015 only, pursuant to transition rules.

expatriate plans are exempt from these benefit mandates, at least through plan years ending in 2016.

US controlled group; and if the member fails the test, the penalty is based on the number of full-time employees of that member.

- Employers must notify their US-based employees and any expatriates covered by a non-US expatriate policy about the coverage they provide and whether it constitutes MEC.
- Employers must report to the IRS
 the number of full-time employees
 and the coverage offered to those
 employees on a monthly basis
 following the end of the year
 and provide individual reports
 to employees.

If in a particular month more than 5% of an employers' US full-time workforce is not offered health plan coverage, the employer could potentially trigger penalties that could rise to \$2,000 annually for every one of its full-time workers, regardless of whether they have health insurance.

Health insurance for expats must be up to standards

The ACA includes various benefit mandates that apply to group health plans that are self-insured by the sponsoring employer, as well as to group health insurance policies.

These requirements include coverage for adult children of employees through age 26, first-dollar preventive care, and a ban on exclusions for pre-existing conditions. The penalty for a group health plan failing to comply with these mandates is \$100 per affected person per day.

Certain insured expatriate plans are exempt from these benefit mandates, at least through plan years ending in 2016. This exemption should relieve many insured policies covering outbound US expatriates (and others working outside their home country) from complying with some of the mandates that are more problematic to administer, such as the complicated rules for appeal processes. However, employers should continue to monitor whether the insurance or health coverage they provide to

globally mobile employees complies with the applicable requirements.

Next steps for employers with globally mobile work-forces

- Identify individuals within the organization who will be responsible for helping individual employees or groups understand and comply with ACA mandates, and what internal groups are responsible for the employer's ACA compliance.
- Establish processes and communications for internal working groups.
- Determine which employees may be subject to or exempt from the individual mandate, and identify groups or individuals for whom it may be unclear.
- Determine which individuals may be considered independent contractors but may have to be considered employees under US common law.

- Analyze benefit programs and health insurance to determine whether the coverage offered to expatriates qualifies as "minimum essential coverage" and explore options.
- Determine whether the employer is subject to the employer shared responsibility provisions by virtue of having 50 or more full-time equivalent employees.
- If subject to the employer shared responsibility provisions, identify which employees must be counted in determining whether the employer meets the requirements.
- Establish measurement and stability periods for individuals not working full-time (e.g., variable hours, part-time, or seasonal) and implement tracking and reporting.
- Perform an annual assessment of compliance with the employer mandate and be prepared to report to individuals and the government on 2015 coverage and compliance.

- Schedule and perform periodic assessments of ACA compliance, incorporating the global mobility population into broader ACA assessments.
- Report to the IRS and disclose to employees the coverage that is provided.
- For more details on some of the rules discussed in this article, see HRS Insight/Global Alert

A prescription for changing times

In a coverage expansion that is one of the largest in US history, millions of Americans are expected to gain health insurance in 2014 under the ACA. Amid such a significant, gamechanging event, employers need to remain abreast of the latest developments and the many nuances of this complex law. Those who have a global footprint and global employee presence need to remember that it's a new, post-ACA world where they should prepare to comply to thrive.





By Iris Goldman and Catherine Marron

The provisions of the Foreign Account Tax Compliance Act (FATCA) were enacted as part of the Hiring Incentives to Restore Employment (HIRE) Act on March 18, 2010. The

FATCA rules generally become effective with respect to certain payments made on or after July 1, 2014. The broad definition of what is a foreign financial institution (FFI) under FATCA covers a number of entities outside of the traditional financial services sector. Given there are a number of requirements and exceptions within the FATCA rules, specific analysis is required to understand the impact to both US and non-US retirement funds.

What is FATCA?

The purpose of FATCA is to detect and discourage offshore tax evasion by US taxpayers who are either the direct owners of financial accounts outside of the United States or the indirect owners of a non-US entity owning the account.

FATCA enables greater transparency by strengthening the US tax information reporting regime by providing prescriptive rules for the documentation and reporting of an account, and imposing a 30% withholding tax on any "withholdable payment" made to an undocumented account holder /payee or a non-compliant foreign entity. Moreover, failure to withhold when required, transfers the liability to the payor.

Defining a foreign financial institution (FFI) under the provisions of FATCA

Generally, a FFI is any non-US entity that:

 Accepts deposits in the ordinary course of a banking or similar business

- Holds financial assets for the account of others, as a substantial portion of its business
- Is an investment entity:
 - » Investment advisors: conducting investment activities on behalf of customers
 - » Entities (i) that are managed by other financial institutions, and (ii) whose income is primarily attributable to investing in financial assets
- Is an insurance company that issues or is obligated to make payments with respect to a cash value insurance or annuity contract
- Is a holding company or treasury center that is part of an expanded affiliated group that includes one of the above, or is formed in connection with a fund or similar investment vehicle

Depending on how a non-US retirement fund is structured, it will generally meet one of the FFI definitions.

Who has FATCA responsibility for the non-US retirement fund?

While a specific review of a retirement fund documents should be performed to determine ultimate responsibility and the segregation of duties among the various stakeholders, the following principles should generally apply:

- A retirement fund that maintains the associated funds in a trust should find that the trustee of the trust will be responsible
- If the fund requires an employer to make annual contributions as a percentage of compensation for each employee (such as due to government mandated requirements) and the contributions are deposited into a state managed or privately managed fund that provides for accounts for employees of multiple employers, then the trustees responsible for the fund's trust should be responsible for FATCA compliance
- Companies should review contracts with third-party administrators, trustees, custodian banks, and the like to ensure that any information required for FATCA compliance will be maintained

The purpose of

FATCA is to detect

and discourage

offshore tax evasion

by US taxpayers.

What types of exception are available to the non-US retirement fund?

Fortunately, many non-US retirement funds are not viewed as high risk vehicles for US persons to hide assets and income to avoid paying income taxes. For example, they may have limitations on the annual amount which can be contributed by an individual to the fund or there is an existing reporting method locally. Recognizing these attributes, the US Treasury and Internal Revenue Service (IRS) have provided for a number of exceptions to treating these funds as FFIs. Companies may find that understanding the definition of a retirement fund in the FATCA regulations and the appropriate exemption (if any) can be a bit of a challenge. For retirement funds exempt from FFI status, all that may be required is the completion of IRS Form W-8BEN-E confirming the retirement fund's status. For non-US retirement funds located in a country where an Intergovernmental Agreement (IGA) exists between the country of organization and the

United States, the types of retirement funds that are excluded from being treated as a FFI are located in Annex II of each country IGA.

The types of retirement funds that are generally excluded in an IGA include pension funds that are legislated in the country such as traditional defined contribution savings plans and defined benefit plans. The IGAs address some of the legal issues raised and establish a framework for FFIs in the relevant partner countries to simplify the implementation of FATCA and the reporting of US account holder information. If the retirement fund is exempt from FFI status pursuant to an IGA, all that will be required is the completion of Form W-8BEN-E confirming the retirement fund is a non-reporting IGA FFI.

If the retirement fund is not located in a country with an IGA, the fund must look to the IRS Regulations to determine if it can qualify as an Exempt Beneficial Owner, and as such, it will not be subject to FATCA withholding requirements or more

onerous reporting requirements for the fund participants. All that will be required is the completion of a Form W-8BEN-E confirming which of the exemptions apply.

The following are the more common types of retirement funds that qualify for exemptions and be treated as Exempt Beneficial Owners:

Treaty qualified retirement fund

Narrow participation retirement fund

Fund formed similar to an IRC Section 401(a) plan

Broad participation retirement fund

Investment vehicles exclusively for retirement funds

Pension fund of an exempt beneficial owner

What should you do now?

Specific analysis is required to understand the impact to both US and non-US retirement funds and the role of stakeholders. However, prior to completing any such analysis, it is recommended that an entity should immediately:

- Complete an inventory of all retirement funds
- Evaluate whether each non-US retirement fund qualifies for an FFI exemption
- Understand the types of investments made by the retirement fund

If an exemption is not applicable, employers should contact fund trustees regarding steps being taken to address potential FATCA coverage and monitor developments that may affect reporting obligations, including whether the home country appears likely to sign an IGA. In addition, the fund may need to register with the IRS and conduct due diligence on all accounts for fund participants. Companies should also review contracts with third-party administrators, trustees, custodian banks, and

Understand how a retirement fund/pension plan is defined under FATCA Determine your obligation for each retirement fund/pension plan you sponsor.

Assess if the fund/ plan can qualify for a FATCA exemption.

Consider the treatment for non-exempt funds.

the like to ensure that any information required for FATCA compliance will be maintained. This could include establishing a controls framework to ensure all requirements to achieve FATCA compliance (i.e., classify foreign retirement fund, register retirement funds that are FFIs, and implement funds for required certifications) and to ensure future compliance, as the retirement fund may need to be provided to the IRS.

In addition to the funds themselves, investments by the funds may be affected by FATCA. Many pension funds invest in a variety of asset management products which are also subject to FATCA. There may be situations where a pension fund has

a dedicated fund established for its investment that may be required to be registered for FATCA purposes by the pension fund even if it does not have to register itself. In addition, financial products and instruments held by the fund should be reviewed to determine whether there is any potential for withholding under FATCA either by the pension fund itself or by the counterparty to the product or instrument to ensure that appropriate documentation is exchanged.

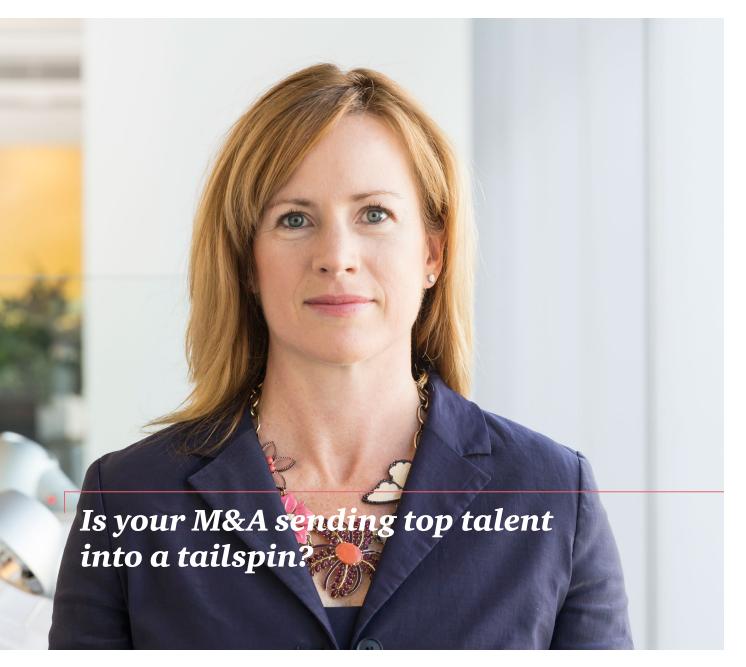
In conclusion

The July 1, 2014 deadline for complying with certain FATCA requirements is approaching. In order to be FATCA compliant

with respect to non-US retirement funds, companies should begin by completing an inventory of all non-US retirement funds sponsored in each country of operation. At the same time, they should have local HR representatives answer a few questions to help during the assessment phase.

Once the inventory is completed, the assessment phase can begin to determine which funds can meet exemptions and which funds will need to be registered as an FFI.

Lastly, don't forget to establish processes and controls to ensure continued compliance with FATCA.



By Katherine Karch

There it is in your driveway. The car you've always dreamed of owning. Oh, the places you will go. Or not. As it turns out, you can't turn the engine on. Because it's missing. The same can happen in M&A when imagined deal value is drained by failure to retain key talent. No engine, no go. Here's how missed opportunities can detour your deal and how you can stave off a talent torrent.

M&A transactions can create significant value for participating businesses, both in terms of cost savings and in increased revenue-generating capabilities. While this is widely appreciated by senior management and business leaders, such deals can fan employee uncertainty about the future of the business and their own job security. Retaining key talent is a critical aspect of a deal's success or failure. This is particularly relevant when most of the organization's value emanates from its people. Research shows that most M&A transactions actually destroy value for shareholders—and the failure to identify and retain talent can be a key contributing force in this dilemma. Identifying key talent during M&A due diligence and designing financial retention plans to entice them to stay after a transaction can be critical to the success of a deal.

The right stuff

It's not always easy to identify talent during due diligence. The seller should be willing to help in an effort to obtain the best price possible by delivering the most value. Usually, you know the industry before you buy, so you should already have an idea of who and what you're buying. And talent is sometimes at the core of that.

Top talent includes the management board and other line managers who have navigated the business thus far and earned their positions through established ability. Others are harder to identify and depend on the industry and the post-transaction situation. Client relationship managers who are close to important customers are likely to be on the list. Other critical sources of value may include creative departments, engineers responsible for key patented processes, or staff responsible for operations.

The specter of uncertainty

Transactions cause uncertainty for employees based on a number of factors, including the future direction of the business, their role in it, job security amid the likelihood of headcount reductions, new leadership, and shifts in company culture. And this uncertainty in turn creates an environment in which people are more likely to leave and less likely to be fully motivated to perform, all of which can undermine value.

Uncertainty can be managed through targeted employee communications and financial incentives. These incentives or retention awards have a number of benefits: they can provide job security for critical employees, reassure the wider employee population about senior management plans, and clarify the future direction of the organization.

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The power of retention plans

Several retention plans are likely to be needed to hold on to the people that can make a deal a success. Different arrangements may be indicated for those critical to successful deal completion and post-deal integration versus those who are strategically critical for the new entity's long-term success. The retention strategy needs to be thought through early in the due diligence process so you can take the time to develop targeted, market-aligned arrangements.

The right retention plan will depend on individual business objectives, integration timelines and targets, and the market for talent for each role in receipt of such an arrangement. The first step is to identify categories of employees who are retention risks. Multiple retention plans should be considered, as, again, the plans will likely differ for those critical to the integration and key talent for long-term success of the new company.

Integration critical makes mission possible

It's particularly important to identify integration critical employees when a merger is likely to result in redundancies and when speedy integration is crucial to limiting disruptions and achieving business synergies. Employees who are strategically critical to the long-term success of the business pose a different challenge.

These are often executives and senior management, and perhaps those with specialized business and intellectual property knowledge. Identifying these individuals maybe difficult during the due diligence phase, as access to employee information can be limited and may require reliance on the judgment of the acquiring management team. By clearly outlining the criteria for candidates who receive retention awards, you can eliminate some ambiguity, but the final approval for retention awards should involve the full range of stakeholders.

Payment

After determining who will receive a retention payment, the size of the awards will need to be evaluated, along with the time period in which the employees' services are critical.

Retention amounts are typically determined as a percentage of base salary and vary by the employee's level in the organization. However, a portion of awards made to executives can sometimes be delivered in equity, which is typically used only when the individual has a reasonable ability to impact the share price of the organization.

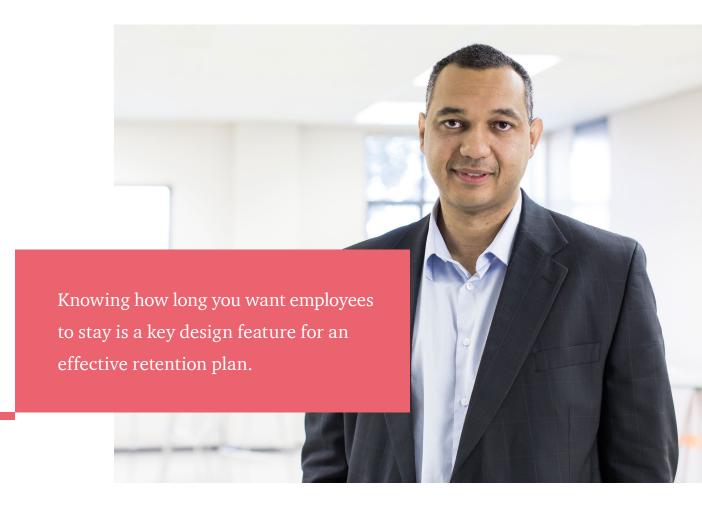
When determining the award early in the due diligence process, consideration should be given to how current salaries fare when compared to the market. Flight risks are more common in situations where the current compensation package is below the median for the industry, especially when there is a competitive market for the business talent. They are also more common when

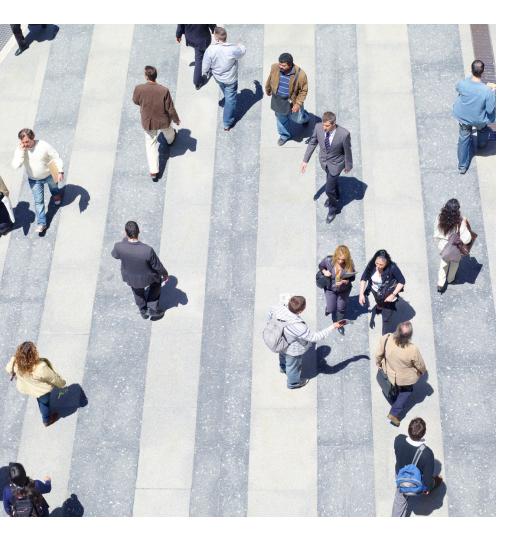
employees are dissatisfied with current processes and the direction of the organization.

Competitors are likely to be willing to pay for top-performing talent, so meaningful retention awards will need to be considered to establish that key players are valued and to lessen the chance that employees will seek opportunities with other companies.

Duration

Knowing how long you want employees to stay is a key design feature for an effective retention plan. Too short a period and you risk losing key talent; too long and you risk paying too much for too long. Most plans have payment conditions linked to key integration milestones based primarily on time. Financial performance conditions are common for senior management. It's important to work closely with the deal team to set key integration milestones to determine the timing for the retention payment.





Integration critical: To support key integration milestones, we typically see cash payments ranging from three to six months of salary, depending on job level, and paid six to twelve months after closing or once certain integration goals are met. Collaboration with the acquired leadership and the deal team will be critical to identify integration-critical employees, the size of the award, and adequate payment timing.

Key talent for long-term success:

Retention of strategically critical employees should be based on the new entity's long-term incentive plan to promote long-term retention and align performance behaviors to business strategies. Existing long-term incentives under the seller's plan are likely to be cashed out upon deal closing, but the new long-term incentive plan typically will not payout for three to five years.

There may be a need, and even an expectation, to offer an extra retention plan to bridge the time before

the first long-term incentive plan payment. Typically, these transaction-linked payments have longer payout periods and are made in installments. For example, one might see two installments over a two-year period with total payouts of six to twelve months of salary.

Transition

The cost of the retention plan should be included in the valuation of the business to obtain an adequate estimate of completion costs. Depending on the situation, the costs can be borne by the seller, the buyer, or split between the companies. The retention program design should be reviewed by tax, accounting, and legal experts before implementation.

Careful attention should be given to the impact of the golden-parachute rules under Internal Revenue Code Sections 280G and deferred compensation requirements under 409A, as well as the expense impact of the proposed retention design.

Monitoring the retention payouts will ensure that actual costs do not deviate from the planned budget.

While the primary focus for retaining key talent is through cash bonuses, non-monetary approaches to retention should also be considered.

Management's commitment to career development and to an organizational framework that aids in the growth and promotion of employees is also valued by employees.

Regardless, an effective retention program (with both financial and non-financial elements) will be successful only if objectives are clearly communicated by the organization in a timely manner.

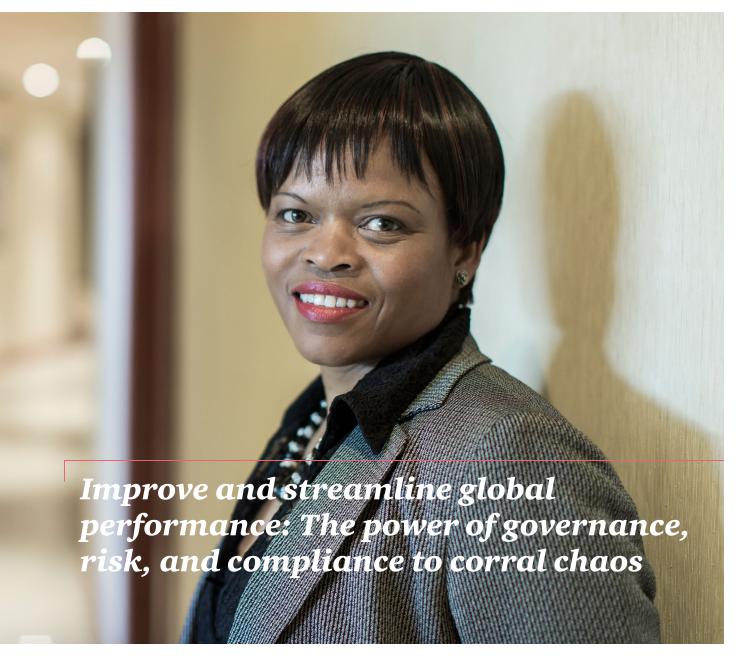
In addition to the financial and strategic considerations with respect to retention award design, regulatory pressures and media scrutiny have recently become significant influences, as well. With a particular focus on European territories, compensation regulations focused on the financial services sector have

sought to limit the use of retention awards to exceptional circumstances. Transactions within this sector must consider the regulatory implications of introducing retention awards and the relevant authorizations and submissions needed.

Success: Taking a drive

There is no one-size-fits-all retention plan approach. But getting an early start on retention planning in the due diligence phase and identifying key retention candidates will support a successful integration and help ensure that deal synergies are realized. In addition to carefully crafted retention plan designs for the array of employee groups, plan communication and clearly defined enterprise objectives can help deal value go from idealized to realized for the organization and the people who power it. If you can retain the right talents, you can take the business where you want it to go.

There is no one-size-fits-all retention plan approach.



By Charles J. Yovino

"I accept chaos, I'm not sure whether it accepts me." —Bob Dylan

As businesses extend their global expansion, they face the challenge of managing an increasingly complex environment in a growing number of countries. The old paradigm of managing in a siloed, decentralized manner is giving way to an integrated approach that follows the principles of governance, risk, and compliance (GRC).

Entities can gain value by strategically integrating GRC into the management model to establish an operational foundation for managing the business. So, what is GRC and how does it work for a global HR organization?

Defining GRC

In short, HR GRC provides a process for overseeing HR strategy, operations, and processes; managing its risks; and supporting its compliance efforts.

GRC is a single, integrated approach to managing co-dependent areas. Risk management cannot be accomplished without strong governance and compliance, and compliance cannot operate in a vacuum devoid of an overarching strategy related to HR objectives, risk appetite, and a cultural and ethical framework.

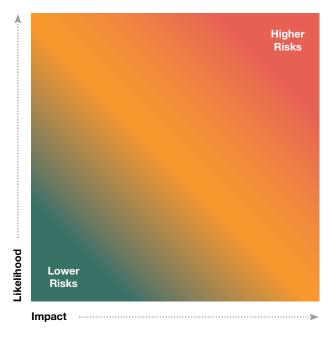
Each facet of GRC plays an overlapping and supporting role. Governance is the system or framework that directs and manages an enterprise through clearly defined roles, responsibilities, and accountability. It is based on general principles against which the enterprise should operate, including elements such as:

- An HR strategy or mission
- Established objectives
- A defined oversight structure with clearly defined roles, responsibilities, and accountability
- A way to measure and monitor performance
- A cultural and ethical framework, sometimes reflected by a code of conduct or conflict-of-interest policies
- Risk management, compliance, and periodic self-assessment

Risk management involves identifying risks (or barriers to the success of the business or specific endeavors), evaluating or quantifying the risks (to help with prioritization and determining how risks will be managed), and managing the risks (including periodic monitoring activities).

Risk that resides with vendors is often overlooked. HR outsources numerous key functions ranging from recruiting to background checks, payroll, benefits administration, and leave administration. The spectrum of risks owned by vendors ranges from erroneous administration (such as overpaying salaries or benefits or hiring of the wrong people) to

privacy breaches and business continuity risks. Some vendor risks create financial exposure or inconveniences; others can cause business disruptions or more serious outcomes. HR needs to understand and inventory the potential risks and weigh them against their potential likelihood and impact.



Risk management, like governance, can be principle-based. Risk management, like governance, can be principle-based, thereby allowing for greater flexibility when working in multiple countries. Indeed, the new COSO internal control framework¹ builds on the original framework of five core components with 17 principles that can be used and adapted to a variety of situations and enterprises.

Compliance activities include operating in accordance with the business-wide adopted objectives while ensuring compliance with the laws and regulations of the local territory, the business' internal policies and procedures, and the range of stakeholder commitments².

Building global HR GRC

Operating HR in one territory alone can be complex. As the number of territories expands and the level of complexity grows exponentially, global HR GRC provides a framework for overseeing multiple territories in a consistent way that allows for clear accountability and simplified oversight. This is because while GRC is principle-based to enable consistency, it is not prescriptive, providing each territory with the flexibility it needs to operate in its distinctive environment.

Let's look at an example to understand how this might work.

Assume you are the CHRO with operations in a number of countries, including the United States, Australia, Japan, and Mexico. You've done a high-level risk assessment of your HR programs and policies and have preliminarily identified as one of the higher risk areas the pension plans in each country.

The business in each country currently operates its pension plan locally, making all decisions related to their plan(s), including design, participation, funding, expense reporting, investment, and the like. You get no or minimal reports about the plans, and the reporting is inconsistent in content and frequency.

Your initial attempt to provide "rules" related to the operation of the plans is to prescribe who locally must serve on the plan's committee or oversight board. You believe that the typical US approach, in which individuals from upper management who have financial and HR backgrounds fill this role, will be a good start.

¹ Internal Control—Integrated Framework, the Committee of Sponsoring Organizations (COSO) of the Treadway Commission (2013).

² PwC Whitepaper on Integrity-Driven Performance, A New Strategy for Success Through Integrated Governance, Risk and Compliance Management (2004). Compliance risk has also been defined as the "risk of impairment to the organisation's business model, reputation and financial condition (resulting) from failure to meet laws and regulations, internal standards and policies, and expectations of key stakeholders such as customers, employees and society as a whole." Survey done by The Economist Intelligence Unit and PwC.

Unfortunately, you subsequently learn that the countries in which you operate present at least three unique legal structures for the pension plans you are trying to manage. There are laws in many of the countries outside of the United States about fitness criteria relating to who can serve as a member of a plan's governing body (such as professional qualifications, experience, language requirements, and possible criminal record).

In addition, the local legal structure for pension plans may dictate who will choose the parties that can serve on the governing body (the employer, employees, or both), or if a financial institution must oversee the assets. Your attempt to replicate what works in the United States (avoiding problems by filling key roles with "strong performers in upper management") is vanquished.

GRC requires one to step back and focus on *managing what is ultimately most important*, based on the principles that serve as the backbone of GRC. Thus, rather than trying to

define who can be on the governing body, one must define expectations (or define the roles and responsibilities of the territories in relation to operating their pension plan), relating to GRC.

Some companies will accomplish this in several pages while others will take dozens of pages. Regardless, here are some examples of what is typically addressed:

· Definition of objective and scope—Each country should describe its objectives for the programs based on an inventory of all plans, a risk assessment, and the operating structure. Although it doesn't seem like the principle of having objectives (and performing the underlying inventory and risk assessment) would need to be done more than once, it will need to be refreshed regularly and perhaps annually because of acquisitions, changes in operations, new legislative or regulatory requirements, outsourcing/insourcing changes, system updates, or the introduction of new vendors.

- Key players identified, and roles and responsibilities defined—Based on the structure of the plan or program, describe the roles and responsibilities of the key players (local board, plan committee, third parties, employee groups, unions, and the like), as well as who is accountable to them and to whom they are accountable.
 - » Governing Bodies—The criteria for selecting members of the governing body should not only reflect the local requirements, but should also detail the minimum level of skills, knowledge, and experience the members should have and the amount of time they are expected to dedicate to the task.
 - » Governing Body Charter—The roles, responsibilities, and accountability to and from the governing body should be outlined in a charter, which should incorporate standard risk management principles such as segregation of duties, avoidance of conflicts of interests, adopting a code of conduct, and the like.

Risk management—

Periodically, the governing body should request from the various parties a risk assessment of their area and how they mitigate or manage the priority risks. The governing body should regularly perform its own risk assessment and evaluate performance against expectations (including for service providers and internal functions), test and monitor controls, and review remuneration, as well as incentives offered to external providers.

 Compliance—All compliance and reporting requirements are identified and periodically reviewed, updated, and evaluated, including a periodic review by counsel.

Ideally, there will be a standardized method of reporting against these criteria. Some companies have even adapted this into a dashboard report, rendering it relatively easy for the global oversight committee to see where a territory is failing to report on or fulfill established principles.

How to develop a global HR GRC

Many companies already have an enterprise-level GRC or GRC framework, which can help integrate the global HR GRC framework with the organization's larger GRC.

However, HR will often confront special situations that require a modified approach. For example, manufacturing operations and financial reporting may be relatively consistent country to country, and the requirements can be standardized or even prescribed for that environment. Indeed, quality standards are likely to be prescriptive. However, the personnel and benefits ecosystem will likely differ from country to country, and these differences require local flexibility.

Whether you are customizing the HR GRC to fit with your enterprise's GRC or implementing something new, it is often difficult to simultaneously address all of HR (policies and programs, benefits, compensation, and payroll) in every territory. In fact, trying to do everything everywhere simultaneously is not consistent with

the general GRC approach, which is to prioritize areas and establish objectives. It is, to paraphrase a saying, better to eat the proverbial global HR GRC elephant one bite at a time.

One can approach this meal in several ways and the best solutions will depend on your organization and its needs. Some approaches we have seen include:

- Limited countries—Launch the HR GRC in a handful of countries, using it as a soft launch to test the approach on a limited basis, and modify it as needed. There are several alternative approaches to selecting the countries for the soft launch, such as focusing on one region, selecting higher risk countries, selecting countries that are better at executing new initiatives, or choosing diverse countries for varied perspectives.
- Limited HR areas—You can also limit the HR scope for the initial rollout. Again, there are a number of ways to decide what areas to implement, such as areas of higher risk (e.g., pensions or privacy), areas involved as part of

a new rollout (e.g., new HRIS or payroll), or programs that seem to be generally well run (providing an opportunity to build on good practices).

Key steps for developing a global HR GRC

Establish initial objectives and scope

As you do fact-finding and learn more about global HR operations, the objectives and scope may change; this is why we say establish initial objectives and scope. Although objectives and scope may evolve, it is important to establish the objectives, since what you want to accomplish will dictate the scope, fact finding, and how to proceed.

For example, the next step involving fact finding and inventorying will be shaped by how the objectives are defined: if the objectives go beyond vendor risk management and also consider cost reductions through possible vendor or asset consolidations, the fact finding and inventorying will have a very different scope.

Fact finding and inventory

It is a challenge for most large organizations to obtain a complete inventory of all HR, benefit, and compensation programs in every territory. There are a number of reasons for this, such as the lack of a central database or the use of different definitions for the programs (or different categorization of programs).

Indeed, some organizations cannot cite an accurate global headcount. This issue can be one of the most problematic and frustrating phases of building a global HR GRC. While seeking to obtain perfection is a laudable goal, the more pragmatic approach is to collect the best available information, knowing that the inventory will grow and evolve over time.

Beyond inventorying the plans and programs, other fact finding may be necessary depending on the objectives and scope. For example, if vendor consolidation is a goal, then inventorying the vendors, investment funds or asset classes, or vendor contracts might be required.

Gap analysis and HR GRC assessment

Using the information obtained during the fact finding and inventorying process, the next step is to do a gap analysis or an HR GRC assessment:

- Is governance in place?
- Where does it lie on a governance maturity curve?
- Have risks been identified, prioritized, and managed?
- Are controls documented, monitored, and periodically tested?
- Are the compliance requirements known, monitored, and satisfied?

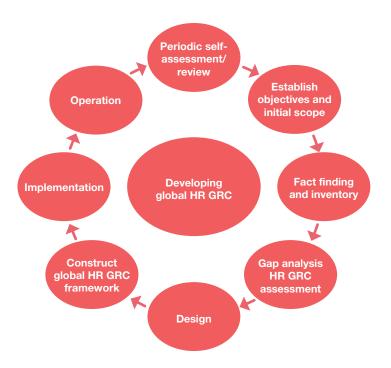
In addition, to truly work toward *globalizing* the HR GRC, it is important to ask if the governance, risk, and compliance standards are based on the principles that will be used globally.

Design

The gap analysis will provide valuable information for the design phase. It will address the design from both a structural perspective (for example, will there be local, regional,

Although objectives and scope may evolve, it is important to establish the objectives.

or central oversight?) and from an operational perspective (is the focus initially on just one region, one set of plans or programs, or on one group of high-risk areas?). This is also the point at which to ensure that the HR GRC is integrated with and supports the enterprise-wide GRC. Looking for these opportunities will help answer the question, what synergies can be exploited and where can redundancies be eliminated?



Construct, Implement, Operate, and Review

The next four phases in the development process are:

Construct the global HR GRC framework: Key documents will be developed, including defining roles and responsibilities, developing dashboards, and crafting controls.

Implement the framework: This will include testing the framework or possibly having a soft launch to assess the framework in a smaller controlled environment.

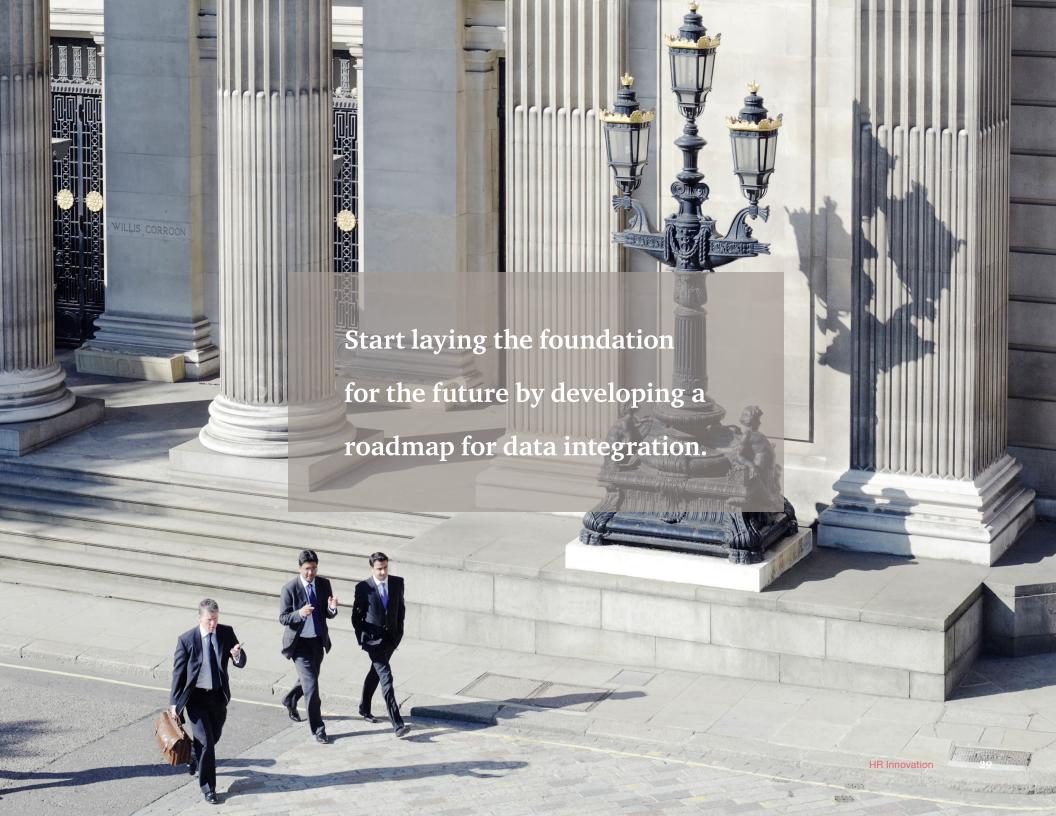
Operate the framework: Move to action; this not the final phase, since it is expected that the framework will constantly undergo review and modification for improvement.

Periodically review and improve the framework: This will lead to new objectives, possibly a modified strategy, and the beginning of the process anew.

Consistent, integrated, global approach

Adopting global HR GRC fundamentally changes HR oversight and operation, creating a consistent and integrated approach that can span all territories, plans, and programs.

It establishes clear, well-defined expectations and specificity relating to roles, responsibilities, and the reporting structure. Reporting is standardized and consistent and dashboards often come into play. This consistent, integrated approach can provide a uniform structure for managing the unique HR, compensation, and benefit structures and programs across the territories in which you operate.



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To discuss how we can help you address your critical HR issues, please contact us.

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