

# Dust Off the Historical Approach to Total Compensation

Employers have been afforded new opportunities with the enactment of the Affordable Care Act (ACA). ACA creates a unique opportunity for employers to take a fresh, strategically based total compensation approach to planning. The concept of a total compensation framework is not new; however, a new way to achieve this approach is now possible. Employers need to create their own level playing field, and a total compensation approach is the optimal solution. This article discusses how employers that consider a framework driven toward total compensation accomplish many key objectives.

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In 2010, the U.S. Congress passed the Affordable Care Act (ACA). The new law and subsequent laws, taxes, rulings and interpretations delivered by the U.S. Department of Labor, Internal Revenue Service, Department of Treasury and Supreme Court provided the most overhauling legislation since the passage of Medicare in 1965.

ACA creates a unique opportunity for employers to take a fresh, strategically based total compensation approach to planning. Consider a framework that accomplishes the following objectives:

- Cost containment related to compensation and benefit programs including health and retirement
- Flexibility to meet diverse employee needs
- Minimal additional administration and compliance
- A competitive-advantage total compensation program that aids in retention and attraction.

## What Is a Total Compensation Approach?

A *total compensation approach* starts with having a total compensation philosophy designed to attract, retain and motivate employees. Accomplishing this requires a blend of base pay, incentive pay, health benefits, welfare benefits and retirement benefits.

Employers today are facing difficult decisions when it comes to one of their most important assets: their employees. Layoffs, salary and retirement plan freezes, pay cuts and health care benefit reductions all are being considered as companies look to cut or contain costs.

Unfortunately, when faced with difficult decisions, employers too often focus on one facet of total compensation instead of making a total analysis. To emerge strong and retain their best people, companies need a total compensation strategy that rewards top performers while effectively utilizing capital.

**FIGURE**

**Strategically Aligned Competitive Compensation and Comprehensive Benefits**

<p><b>Competitive compensation</b></p> <ul style="list-style-type: none"> <li>Pay communications</li> <li>Base strategies</li> <li>Variable strategies</li> <li>Market pricing</li> <li>Retirement</li> <li>Time off</li> <li>Health</li> <li>Income protection</li> <li>Benefit communications</li> </ul>	<p><b>Delivered effectively</b></p> <ul style="list-style-type: none"> <li>• Efficient standardized tools and systems</li> <li>• Permitting employee choices of total compensation packages tied to their needs while being cost-effective</li> </ul> <p><b>Enrichment through employee education and communications</b></p> <ul style="list-style-type: none"> <li>• Data</li> <li>• Consultation</li> <li>• Alignment</li> <li>• Locally competitive</li> </ul>	<p><b>Strategically aligned</b></p> <ul style="list-style-type: none"> <li>• Business</li> <li>• External market</li> <li>• Company values</li> </ul>
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The concept of a total compensation framework is not new. What is new is the concept of a coordinated approach of dealing with double-digit increases in benefit costs, balancing life/family demands and attempting to create an employment environment that does more than attract, retain and motivate. Both employees and employers are looking for more ways to connect and forge a mutually beneficial relationship. Clearly, job content, opportunities for advancement, work environment and recognition are all part of a total plan.

**Creating Total Compensation Package Options**

Utilizing this new methodology, employers stop viewing their benefits in silos, i.e., medical, paid time off (PTO), disability and retirement. They change their philosophy to a total compensation approach that provides for cost efficiencies, eliminates duplicate coverages and increases their awareness of risk management issues. Employers are recognizing that it is not enough to be competitive; they need to be an employer of choice.

Simply stated: Can an employee receive a different package of total compensation opportunities including different base compensation, time off, health and welfare benefits

and retirement? How does an employee value the amount of money in his or her take-home pay vs. how much other needs are satisfied?

ACA created alternate external offerings that can be effectively leveraged and utilized without compromising a company's ability to be competitive. This can be taken further by permitting employees to make trade-offs in pay and benefits to suit their individual circumstances. From an employer's perspective, establishing a total cost price tag for each option also assists in meeting budget demands.

Creating competitive compensation and comprehensive benefits is always a goal. Employers can design ways to deliver these effectively, permitting choice and being cost-effective. These programs also must continually be aligned with a company's external market and values, as summarized in the figure.

**Process for Analyzing the Opportunity—Overview**

*Complete benchmarking.* The first step is to complete compensation and benefits benchmarking to determine the current standing in the relevant marketplace. If we ultimately are going to offer choices, capturing good market data on pay and benefits is essential. Each position can have trade-

offs of pay without sacrificing an ability to attract and retain top talent. This is because under the new model, an employee can elect to make trade-offs based on the value placed on each item. For example, an employee may be willing to trade less compensation for more time off or an alternate benefit level.

*Analyze impact of health care reform.* The results of this analysis will clearly direct an employer's positioning on core benefit plans. Are we going to be faced with the Cadillac tax? How many of our employees are eligible for federal tax subsidies if coverage is purchased on the exchange? Are our core plans meeting the requirements for providing minimal essential benefits and are they affordable?

*Review ancillary, time-off, retirement and voluntary offerings.* Once the benchmark noted above is complete, determine variances from the marketplace and potential solutions.

*Model alternatives.* Once the inventory of benchmarking is complete, including a total cost analysis on where and how dollars are being spent, begin the process of creating alternate total compensation packages. The initial designs will certainly uncover issues with compliance, administration, reporting, etc. But these issues create opportunities to refine and alter the models.

**Health Care Reform Review**

Employers currently have viable external options, with even more enhanced options available in the future. With preexisting conditions and expenses, there was no real marketplace.

**TABLE I**

**Possible Variables to Be Included in Designs**

Base compensation	Long-term disability (base with buy-up)
Retirement 401(k)	Nonqualified retirement
PTO	Incentive compensation
Medical/Rx (POS, HMO, PPO, HSA/HRA)	Critical illness insurance
Dental (company-sponsored/voluntary)	Short-term disability or A&S insurance
Vision (company-sponsored/voluntary)	Wellness
Life (company-sponsored/base with buy-up)	Long-term care

Whether we like the marketplace, don't like the marketplace, disagree with private exchanges, don't like public exchanges, whatever, they are here to stay.

The marketplaces offer us an opportunity to look at how we deliver and provide medical benefits that then create an entirely different platform. In addition to providing viable external options, ACA is about more than just financial considerations: It provides freedom to design plans to fit specific needs.

A proper starting point is a health benefits review utilizing modeling tools estimating the effect of ACA on plans. This will educate all stakeholders and provide a blueprint to make changes. The review will provide options to the employer and employees.

Employers need to consider multiple strategies for:

- Different business lines
- Different business locations
- Different types of employees

- Part-time employees
- Type of workforce needed
- Hourly vs. salaried employees.

This analysis will provide employers with baseline possibilities, including:

- Maintain current plan design and employee contribution strategy.
- Stop offering group medical insurance (with or without any compensation adjustment).
- Offer a 60% actuarial value plan.
- Offer a program that will fail contribution requirements (e.g., 9.5% of compensation).
- Offer 75% to 90% plans as alternatives to some extremely rich plan.

**Model Alternatives**

Armed with data from this analysis, we can now model options (Table I). Programs can be designed around total pay packages that address cost containment as well as flexibility to meet diverse employee needs while not cre-

**TABLE II**

**Creating Total Compensation Flexibility—Preliminary Concepts**

<b>Current Scenario</b>	<b>Possible Options to Create Flexibility</b>	<b>Comments</b>
Compensation is at 50th percentile	Reduce compensation to gain access to other more employee-driven options or increase and opt out of other packages; alternate ideas for hourly and part-time employees	Market will not be sole driver for compensation levels; now there is ability to move up or down
Company-sponsored 80/20 PPO; LTD, dental, vision	Substitute core plans with various alternate arrangements	Create voluntary programs; HRAs, alternate PPO and contribution scenarios
401(k) match	Match can be provided to HRA/HSA and/or 401(k)	Match to HSA or HRA participation; not just for 401(k)
Standard PTO	Trade up or down	One size does not have to fit all.

ating administrative nightmares. These new designs will create a competitive advantage for employers.

Currently, most employers offer all benefits as one size fits all.

Table II details preliminary concepts of creating flexibility regarding total compensation.

The possible options create intriguing questions:

- What about our core plan? What will our core plans be?
- Do we have a core plan for medical and offer a buy-up or trade-down?
- We have a 401(k) match. Right now, if we're willing to spend a percentage of pay, do we as an employer care whether or not it goes to a health reimbursement arrangement (HRA)? A health savings account (HSA)? Or the 401(k)?
- Standard PTO vs. a trade-up or a tradedown?

**Potential Offerings**

In reviewing the options below, it is important to understand these are choice total package options; employees would choose a full option package, not a benefit within the option.

Table III illustrates the potential structure/components of this approach for a non-highly compensated employee. Others can be created along differing pay lines, business units or other categories.

Employee X (current option) is being paid for his or her position at the 50th percentile with a market base pay of \$61,500. Employee X is offered a standard preferred provider organization (PPO) 80%/20% plan and standard PTO plan, along with dental, vision, a two-times-salary life insurance benefit, a 66.6% disability benefit and a 401(k) (50% match up to 6%) plan. The total compensation approach cost for Employee X is \$78,500.

This historical approach is effective only if all employees have the same needs, goals and priorities. It fails to consider different types of employees with different needs, goals and priorities. Employees may be interested in:

- More time off and willing to trade pay for more time off
- Trading medical benefits
- Some type of other option as opposed to an opt-out payment
- Using an HRA or HSA
- Voluntary dental and/or vision
- Receiving a match for an HRA or HSA.

**Package Choices**

*Option One*—(Table III) Employee A prefers to take more time off and is interested in trading current components of total compensation, including opting for either an HRA or high-deductible health plan (HDHP). Employee A is willing to absorb a larger

**TABLE III****Package Choices for Non-Highly Compensated Employee**

	<b>Current Plan</b>	<b>Option One</b>	<b>Option Two</b>	<b>Option Three</b>
Base Compensation	\$61,500	\$49,200	\$61,500	\$73,500
PTO	15 days	25 days	15 days	15 days
Medical/Rx	80/20; \$500/\$1,000; \$250 employee contribution	\$5,000 HRA or HSA	\$7,500 HRA or HSA	n/a
Dental/Vision	Included	Voluntary	Voluntary	Voluntary
Life/Disability	2 X pay/66.6%	2 X pay/66.6%	1 X pay/66.6%	2 X pay/66.6%
Retirement Plan	50% match to 6% of pay to 401(k)	25% match to 6% of pay to HRA/HSA or 401(k)	50% match to 6% of pay to HRA/HSA or 401(k)	50% match to 6% of pay to 401(k)
Total Cost	\$78,500	\$67,500	\$74,300	\$78,500

**TABLE IV****Package Choices for Highly Compensated Employee**

	<b>Current Plan</b>	<b>Option One</b>	<b>Option Two</b>	<b>Option Three</b>
Base Compensation	\$115,500	\$100,000	\$94,500	\$125,000
PTO	20 days	25 days	30 days	15 days
Medical/Rx	80/20; \$500/\$1,000; \$250 employee contribution	70/30; \$1,000/\$3,000 \$300 employee contribution or HRA contribution of \$8,000	\$7,500 HRA or HSA	n/a
Dental/Vision	Included	Voluntary	Voluntary	Voluntary
Life/Disability	2 X pay/66.6%	2 X pay/66.6%	1 X pay/66.6%	2 X pay/66.6%
Retirement Plan	50% match to 6% of pay to 401(k)	25% match to 6% of pay to HRA or 401(k)	50% match to 6% of pay to HRA/HSA or 401(k)	50% match to 6% pay to 401(k)
Total Cost	\$135,000	\$130,000	\$115,000	\$131,500

**TABLE V**

**Package Choices for Part-Time Hourly Employee**

	<b>Current Plan</b>	<b>Option One</b>	<b>Option Two</b>	<b>Option Three</b>
Base Compensation	\$12/hour (30 hours per week; 45 weeks per year)	\$10/hour	\$15/hour	\$10/hour
PTO	—	—	—	Ten paid days/year
Medical/Rx	Yes, if worked 30 hours/week —last rolling six months; 20% share	\$5/hour worked contribution to HRA (maximum \$8,000/year)	—	\$4/hour worked contribution to HRA (maximum \$7,000/year)
Dental/Vision	—	—	—	—
Life/Disability	—	—	—	—
Retirement Plan	—	—	—	—
Total Cost	\$27,000	\$21,000	\$20,250	\$22,500

deductible on the medical plan and is willing to reduce the amount of match received for a retirement plan because he or she recognizes the value of sacrificing pay for more time off to balance life/work demands.

*Option Two*—Employee B prefers the standard PTO and would be satisfied with a contribution toward an HRA or HSA, as Employee B is single, so life and disability benefits can be minimal. Employee B is preparing for ultimate retirement and prefers the 50% match.

*Option Three*—Employee C prefers to maximize compensation and is willing to opt out of all benefits plans with the exception of standard PTO, disability and retirement. A more creative base pay and/or incentive compensation plan is Employee C's motivation.

Table IV illustrates the same concept for higher paid individuals.

Table V provides a real-life example of balancing a part-time hourly employee workforce. It illustrates the historical practices regarding the treatment for part-time employees who worked 30 hours a week and were employed for at least six months. Once deemed eligible, these part-time employees were eligible to enroll in the medical plan, contributing 20% of the costs. After modeling options and

surveying employees, it was determined that based on the amount of work flow per week, the employer could attract and retain employees for \$10 an hour without providing benefits. (Option One).

There was another group (Option Two) of part-time employees who wanted more pay. Option Three represented part-time employees who wanted a benefit program including PTO.

**Drawbacks**

Every new concept may create new problems and issues. Considerations and solutions will need to be developed to manage:

- Medical/Rx: high employer/employee current costs
- PTO
- Adverse selection
- Discrimination testing, while understanding that an employer can always discriminate against highly compensated people
- Pay equity (changing an employer's entire compensation philosophy)
- Administration/compliance.

## Strategic Considerations

Employers need to:

- Reassess the role they play in promoting and insuring the health of their employees
- Reassess the role they play in providing base pay, incentives and other benefits (e.g., retirement, time off, etc.)
- Create an environment to maintain a healthy and present workforce that engages and challenges high-performing employees.

## Paths of Consideration

In developing strategies for total compensation, employers have choices:

- Annual trend migration of benefits and compensation (status quo) or
- Interface with a variety of external resources, such as public and private exchanges, and create alternate pay and benefit strategies.

We currently follow a model of one size fits all, with trade-offs typically being created within medical plan designs for buy-up/tradedown with different deductibles, copayments, etc. Alternately, "defined contribution" approaches to medical and other benefits will not solve all issues without completing the analysis on all aspects of total compensation.

## Conclusion

ACA creates a unique opportunity for employers to take a fresh, strategically based total compensation approach to planning. Consider a framework that contains and accomplishes the following objectives:

- Cost containment
- Flexibility to meet diverse employee needs while not creating administrative and compliance nightmares
- Creating a new competitive advantage that will increase retention and attraction.

ACA does create a new health care environment and a different avenue to approach total compensation for both employers and employees.

Employers need to create their own level playing field, and a total compensation approach is the optimal solution.

## Case Studies

Looking at two organizations that have implemented a total compensation approach, we can identify both cost savings and competitive advantages.

### Case Study A

For a hospital with numerous part-time employees in a multitude of categories and with varying hours (15 hours, 22 hours, 28 hours), it is very important that services be delivered in a cost-effective manner with all types of differing arrangements. That gets hospital benefits staff thinking:

- What kind of workforce are we going to need?
- What type of resources/people are we going to need?
- What about hourly vs. salary?
- We can pull it all together now because it no longer has to be one size fits all.

The review initially provided that:

- The current benefit program required a number of changes to become compliant with ACA.
  - These benefit changes produced an increase in the current cost of the program.
- Numerous employees would be eligible for the new federal subsidy.
- There were increased costs associated with ACA for the new fees related to health care (Patient-Centered Outcomes Research Institute (PCORI) fees and a Transitional Reinsurance Fee (TRF) of approximately \$150,000).
- A Cadillac tax<sup>1</sup> of \$2 million would be expected in 2018.

*Status:* Currently, the hospital is facing a 2018 Cadillac tax of more than \$2 million that escalates to more than \$5 million by 2022. It is continuing to monitor legislation and costs while working toward implementation of developed strategies.

Additionally, the hospital initiated a termination of the already frozen defined benefit plan.

### Case Study B

A manufacturing organization with multiple business lines, multiple geographic locations and multiple collective bargaining agreements began with reviewing its obligations

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and options under ACA. Initiating this review with knowledge of the total compensation approach, the employer was open to approaching the review thinking beyond just health care.

Options considered were:

- A review of all of the organization's options relative to benefit plan changes
- Availability of exchanges, both public and private
- The cost and impact of eliminating the benefit program and paying the penalty

Numerous areas were identified where the employer could

actually provide plan improvements and save costs while simultaneously increasing other benefits outside the health care silo to increase retention and continue to attract talent.

*Status:* Currently, the manufacturer is facing a \$125,000 TRF, a \$4,000 PCORI fee and a \$500,000-plus Cadillac tax in 2021 that escalates to over \$1 million by 2022. The organization is monitoring legislation. As it enters into collective bargaining negotiations, the company has found it vital to understand a total compensation approach in order to position itself with strategies and a solid story as to its position.

The manufacturer developed awareness for options to reduce its retiree liability and implemented a structured approach that offered a stipend and allowed for the purchase of benefits through the exchanges. 

## Endnote

1. Come 2018, as the law stands today, employers that are deemed to be providing health plans that are too rich will be subject to an excise tax penalty otherwise known as the Cadillac tax. Plans subject to this tax will have to pay a 40%, non-tax-deductible fee on the value of health coverage that exceeds \$10,200 for individual coverage and \$27,500 for family coverage in 2018. After 2018, the costs upon which the plan will be measured against will be based on the Consumer Price Index (CPI) amounts dictated by the government. Based on the current cost of organizations' medical plans, it is estimated that organizations will begin to incur significant penalties beginning in 2018 and beyond unless measures are put into place to curb the current cost of the health care plan.

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