INSIGHTSINTO

OPTIMIZING BENEFITS AND COMPENSATION

FOLLOWING THE RECENT TAX BILL

AUSTIN BAKER

Austin Baker infuses innovation and creativity into human resource strategy. Austin is the President of HRO Partners; a human resource consulting & outsourcing firm. Austin's personal specialty is in leadership development and employee benefit strategies. HRO Partners represents private sector and public-sector entities with benefit administration and enrollment, recruiting process outsourcing & workforce solutions, compensation administration, training and development, HR Technology and strategy. HRO is also a general agent for many insurance carriers that enables them to work with benefit brokers and companies for carrier funded enrollment services and is one of the largest US producers for Colonial Life Insurance.

What are the major provisions that are included in the 2018 tax bill?
Baker: The bill's major provisions include lowering the corporate tax rate to 21%, effective in 2018, and repealing the individual mandate under the Affordable Care Act, beginning January 1, 2019. Though, this bill will likely have a varying impact on many different organizations of all sizes, it's goal is to essentially give greater tax breaks to larger organizations in hopes of it trickling down to the US workforce.

Below, we've highlighted areas of potential interest to HR executives that are beyond the law's headline changes to tax rates and the standard deduction. The new provisions take effect in 2018 unless otherwise noted. The bill:

- Expands disincentives for certain executive compensation
- Adds a temporary tax credit for certain paid leave programs
- Eliminates deductions for sexual harassment and sexual abuse settlement payments and attorney's fees if payments are subject to a non-disclosure agreement
- Suspends the moving expense reimbursement exclusion and moving expense deduction
- Disincentives for certain fringe benefits
- Provides tax credits for FMLA for 2018 and 2019
- Allows employees of private corporations to defer income on stock received upon exercising an option or the settlement of a restricted stock unit

What is the reception from companies in regards to the new legislation?
Baker: Optimism for business growth is at an all-time high after the announcement of the tax bill. In a study by the NAM's (National Association of Manufacturing), Manufacturers' Outlook

Survey for the fourth quarter of 2017, manufacturers' optimism has risen to unprecedented heights amid the legislative progress made on tax reform. Findings show:

- 63% of respondents said comprehensive business tax reform would encourage their company to increase capital spending
- 57.9% would expand their businesses
- 53.8% would hire more workers
- 48.8% would increase employee wages and benefits

What dynamic initiatives have progressive organizations made after this tax bill?
Baker: So far, several notable organizations have been making news considerable news in junction with these tax breaks.

The following are just a few diverse examples of how some companies are using the additional capital from the tax breaks to invest into the economy:

APPLE
CUPERTINO, CALIFORNIA

$2,500 employee bonuses in the form of restricted stock units; $30 billion in additional capital expenditures over five years; 20,000 new employees will be hired; increased support of coding education and science, technology, and engine

FEDEX
MEMPHIS, TENNESSEE

More than $3.2 billion in wage increases, bonuses, pension funding due to the recent tax cuts. Pay raises, bonus increases, pension plan increases, and at least $1.5 billion in capital expenditures

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VISA

FOSTER CITY, CALIFORNIA

Significantly increased permanent contributions to employee 401(k) accounts

WAL-MART

BENTONVILLE, ARKANSAS

Base wage increase for all hourly employees to $11; bonuses of up to $1,000; expanded maternity and parental leave; $5,000 for adoption expenses

How has the tax bill impacted employees beyond compensation?
Baker:

SHORT-TERM LEAVE

The Family and Medical Leave Act is a federal law that guarantees employees at larger companies up to 12 weeks of leave each year, although employers do not need to pay workers for that leave. The new tax law provides a partial tax credit to employers who offer wages during those times.

"It's an incentive for employers to offer paid time off," said Karen Frost, Vice President of Health Strategy and Solutions at Alight. "We could see employers moving in the direction of offering some pay during those family leaves as a result of the tax change."

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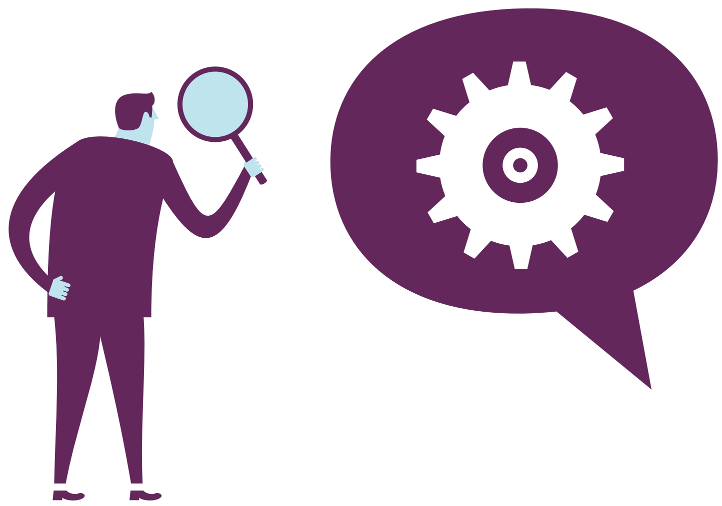
401(K) LOANS

Workers who have an outstanding loan from their 401(k) account when they leave their employer also get some relief.



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Generally speaking, when you leave your job, voluntarily or otherwise, and still owe money on a loan from your 401(k) account, your employer will give you a short window to repay it. If you do not, the amount gets deducted from your account balance. In other words, you pay off that loan whether you want to or not.

However, pre-2018, if you rolled over your remaining 401(k) balance to an IRA or another employer plan, you would be taxed on the loan balance unless you could come up with that amount to contribute to your rollover account within 60 days. In other words, the loan balance had been treated as a taxable distribution at that time and potentially subject to a 10 percent early withdrawal penalty.

"When you're in between jobs it's hard to come up with the money to pay a loan back. Now you'll have more time to come up with it." - Greg Long, Public Policy Leader at Alight Solutions.

Now, you get until your tax-due date (typically April 15) of the following year to put that loan amount into your rollover account without it getting treated as a distribution. "When you're in between jobs it's hard to come up with the money to pay it back," Long said. "Now you'll have more time to come up with it."

The new tax law also eliminates some deductions available to employees or employers, and makes other changes that could affect employee benefits.

MOVING EXPENSES

When an employer paid for a worker's moving expenses due to a new job or relocation, the amount was not taxable to the employee. The new law suspends that tax-free treatment through 2025, which means it will be considered income to the employee and taxed as such. The exception to this rule is for active-duty military members. Theoretically, an employer that pays for a move could increase the employee's gross pay to reflect the taxable moving expenses. This could potentially impact employer policy.

EMPLOYEE AWARDS

In the tax legislation, lawmakers included a definition of what can be given as tax-free achievement awards. While not intended to mark a change in the law, it does codify what can and cannot be excluded from an employee's income.

In simple terms, if you are given cash or a cash equivalent, such as a gift card, meals, lodging or tickets, they are taxable. Awards considered tangible property, like a T-shirt or mug, are not taxable.

How can you create innovative compensation practices through human capital management and organization design initiatives?

Baker: There have been policy changes for more flexible hours, better leave policies, larger healthcare contributions, community giveback opportunities, stock share, and more. Understanding alternative reward development around this tax bill is critical for maximizing the potential of the workforce engagement.

An internal HCM upgrade could maximize the efficiency and return of the organization's re-investment of the tax savings significantly. A few areas where investing in a more efficient HCM platform, which could improve and optimize functions, include:

• Core HR: including payroll, benefits administration, onboarding, compliance management and maintenance of employee data.

• Talent management processes for recruiting, developing and retaining employees.

• Workforce management processes for deploying employees with the necessary skills to particular regions, departments or projects including time and attendance management, workforce planning, labor scheduling and budgeting.

• Service delivery including HR help desks, intranet portals, employee self-service and manager self-service.

As the tax break money flows in, the malleability of an organization's benefits package offerings will increase. Incoming capital creates the flexibility for an organization to meet the challenges posed by business realities and significantly increases the likelihood that the collective efforts of people will be successful.

Upgrading the strategic plan of the organization business strategy dictates the design principles of the future-state organizational model, making possible the alignment of strategy

and structure. Based on business strategy and conceptual design, companies can look across several organizational dimensions (e.g. capabilities, talent, culture, leadership) to improve performance, meet organizational objectives, and strengthen operational efficiency.

What are some practices employers have been using to maintain the sustainability of their new benefits initiatives?

Baker: Many companies invest their tax breaks into a portion of their business and/or community with a belief it will benefit them in the long-term. These investment practices include one-time bonuses, raises, pension funding, benefits contributions, and increased community giveback efforts.

One practice that seems to be the most popular for most organizations is the one-time bonus. Willis Towers Watson, in an analysis of public announcements made by employers found that as of January 12th, 88 companies have committed to making one-time bonuses ranging from $150 to $3000, compared with 35 that have adjusted their minimum wage and 10 or so others that have announced some other form of compensation or salary change. Why are the one-time bonuses more prevalent than the raises? Many argue the answer to that question is the long-term cost savings. Bonuses are easier for employers to hand out than bumps in base pay because they don't increase a company's fixed costs over time, while salaries represent the single largest percentage of direct labor costs. The one-time bonus easily generates good will, puts money into employees' pockets, and doesn't add any long-term compensation commitment.

From the employer's standpoint this is obviously a dream! A one-time benefit to temporarily increase morale and workplace engagement, all while receive amazing PR (as seen by all the positive news articles). However, some would argue that from the employee's viewpoint, the investment will likely not be viewed as effective as a raise. Trends have shown that employee job satisfaction and engagement increase alongside higher salaries and plateaus after a certain point is reached. Though this method proves to be costlier, increasing the salary will be a better long-term commitment to maintain the engagement of employees.

Why is benefits education and communication so important for the effectiveness, and reach of a company's benefits offerings?

Baker: With the consumer-driven benefits approach, if you don't effectively educate employees on their benefits, employees perceive the approach as mere cost-shifting. That's why effective benefits education is vital. A benefits partner can bring you not only product solutions but also benefits education solutions, such as one-to-one employee sessions that cover core benefits in addition to voluntary benefits. Technology solutions alone will not result in more understanding from your employees. The conversation is more personal and taking time to do it right can yield tremendous results. When done well, benefits education can help employees learn about their benefits and learn about the value of what their employer provides. These sessions can be provided in multiple channels ranging from call center, to face-to-face, to web co-browsing private webinar style sessions.

In fact, a Harris Interactive poll conducted by Colonial Life showed that 82 percent of workers who rated their employee benefits education highly, also rated their employer an excellent or very good place to work. Conversely, only 27 percent of workers who rated their employee benefits education as fair or poor said their employer was an excellent or very good place to work. Find a quality enrollment partners and voluntary benefits provider who can help you successfully implement the consumer-driven benefits approach by bringing manpower, technology, voluntary coverage choices and effective benefits education capabilities.

WITH EFFECTIVE COMMUNICATION

HEALTH CARE 83.6%

Companies Providing Above-Average Benefits

HEALTH CARE 76.2%

Companies Providing Below-Average Benefits

WITHOUT EFFECTIVE COMMUNICATION

HEALTH CARE 25.7%

Companies Providing Above-Average Benefits

HEALTH CARE 22.1%

Companies Providing Below-Average Benefits

From our experiences, what trends have we noticed in regard to employee reception changing benefits?

Baker: Most of the time when large companies improve their benefits, the employees do not immediately get that same perception. The most common question we get from employees is usually in a somber, droning voice, asking "What changed and how is it going to cost me this year?" Many times, HR departments are looking to take the path of least resistance to try and minimize excess strain on an already strained department.

After sitting down with thousands of employees, we found that both employers and employees are missing out on one of the best opportunities, for quality interaction that they have all year. For employers, open enrollment is an opportunity to roll out new innovative benefits, drive additional engagement, boost satisfaction and even accomplish other tasks such as cleaning up employee data, rolling out new HR technology, and shaping behavior relating to benefit utilization. For employees, it is an opportunity to make sure that they are still protecting their families and getting the most out of their benefits program. It is a chance for the majority of working Americans to take a pause and assess their changing life needs.

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The challenge is helping employees make informed decisions about one of the more complex and contingency based areas of their personal planning. For the majority of employees, their employer benefit offerings represent the only financial and insurance safety net that they have. Far too many employees do not even know what questions to ask as it relates to their benefits offerings, they often turn to the person next to them to ask "What did you do", or they take it home and relegate the task to a spouse, or who is most likely not trained to ask the right questions either.

Needs are changing and the financial stability of many employees is not getting better. Higher education costs are soaring, leaving younger workers strapped with significant debt and older workers struggling to help fund their children's education. Elder care costs are putting financial, emotional and time strains on employees in a variety of age groups. Younger workers are placing a higher premium on flexibility and paternity benefits. All the while, adoption of driven plans continues to grow, increasing the financial hurdle to access sometimes even basic care. Many employees still can't afford an unexpected $500 bill.

The social contract for work has also evolved, increasing turnover among employers, not just for millennials. New data is showing that generation X and boomers are transitioning even more than ever before as the competition for talent is increasing. The most innovative companies are leading the way in introducing new benefits, both employer-paid and voluntary.

Page after page of benefits communications material will be produced. Benefits administration technology and communications portals will be updated and built. Other print and email communications materials will be deployed. Yet many surveys show that only 35% of employees are extremely satisfied with their benefits.

How can employers and advisors communicate, educate, and engage working Americans to truly understand their options and make better benefits decisions?

Baker: This is where Thaler's work comes into play for us HR Professionals. I picked up my dusty copy of "Nudge", a 2008 best seller co-authored by Thaler. The Royal Swedish Academy of Sciences, which is by all accounts a very smart group of people, reviewed the work and claimed that, "Nudge has built a bridge between the economic and psychological analysis of individual decision making." I think they just described what happens in the choosing of benefits. This policy is also credited with clearing the way for negative enrollment into 401(k) plans. So, let's break this down a bit.

Thaler's body of work includes insights on the ways in which limited rationality, social preferences and a lack of self-control affect decisions that shape market outcomes. Thaler's work around decision science and choice biases prove that the best way to help them make the best decision is to nudge their choices and give them the extra push to the direction you believe would best benefit them. If your workplace implements a new 401k plan but your employees have no idea what it is and if they should enroll, you of course would want someone to educate and help them choose the best plan! Giving a nudge by anchoring answers, limiting availability of choices, and creating proper decision framing impact businesses and employees for the better to provide the best plans for employees while cutting cost for employers.

How can you use those decision making biases to your advantage?

Baker: We can use decision science to help put different decisions at eye level. For instance, "Anchoring" a medical plan choice as a base plan and placing a couple of other choices in front of employees that are smartly designed can influence which medical plan employees choose. This can produce intended and unintended consequences which can increase or decrease satisfaction. Helping employees ask a few questions to "carrot" them into more consumer driven plans coupled with decisions science can positively impact outcomes for your enrollment.

AVAILABILITY

Another strategy that we can pull from Thaler's work is around Availability Biases as it relates to guaranteed-issue products; these are products designed to be extremely affordable options to create safety nets for major medical expenses. Communications around these opportunities should be targeted and limited. One mistake we see is offering too many of these, which results in fewer decisions being made, because it is simply too much to process. So, too much availability can be a bad thing.

OPTIMISM AND OVERCONFIDENCE

Everyone thinks they are an above average driver, right? One force that, these strategies are always fighting is optimism and overconfidence as it relates to employees perceived risks which are often uninformed. Specific year-round communications can help overcome this.

FEAR OF LOSS AND FRAMING

The last two biases relate to Fear of Loss and Framing. When eliminating options, framing the alternatives in the right light is always key to success. On their own, these two biases hold enough sway over our human psyches. I have always said that people will fight twice as hard to keep something that they have rather than going after something new, and this is absolutely true. So, structuring options during passive enrollment situations is important. Default options really matter. Framing changes to keep employees informed and not feeling manipulated is also key to success. What if your doctor says, "Out of one hundred patients who have this operation, ninety are alive after five years," now compare that with "Out of one hundred patients who have this operation, ten are dead after five years".

In conclusion, companies are recognizing and maximizing the potential that the tax bill could bring to their organization. HOW they tap into that potential is what will set them apart from their competition and will overall be the deciding factor in the effectives of the changes in benefits, compensation and HCM of these initiatives. By incorporating benefits counselors into the decision making and education of enrollments, and HR consultants in the compensation strategy and rewards development process, your organization will get the ROI you need from your people investments.

At HRO Partners, We specialize in benefits enrollment administration and human resource consulting. Our specialty is to become the HR department for companies that do not have one and providing more horsepower to companies that do. HRO Partners provides everything from basic compliance level services to engagement strategies and strategic level services. HR can be very complex and we enjoy solving complex problems by providing simple yet elegant solutions.