B E S T P R A C T I C E S I N

Compensation & Benefits

August 2010 www.blr.com Issue 768

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Compensation Programs: 4 Opportunities Emerging from the Recession

Maybe it's too soon to look backward and really gain insight into how the recession has changed our pay programs and the way employees see them. The perspective may be wrong; perhaps the whole picture will come into view much later. But just maybe there are already lessons we can learn.

Only 3 years ago, "Help Wanted" was a common phrase in many industries. Pay continued to climb, and benefits seemed like an entitlement. Now that employees are easy to find and happy just to have a job, it might seem like a good time to snap up some bargains.

But Christine Tande, CCP, of Tandehill Human Capital, says there are different lessons she hopes people will learn. At the same time, she acknowledges that hope and reality are often different.

"There is what you wish for, and there is what actually happens," she says. "There are a couple of things that I hope will be sustained, but it's too early to tell."

The building is burning, and a window has opened for a brief moment. Whether you will take advantage of it is up to you. Here are the four lessons and opportunities in compensation Tande hopes you will take away as the situation improves.

Opportunity #1

The entitlement perception versus pay for performance. The recession gave employees a different perspective on their jobs. In the white collar, mid- to large-sized employer environment in which Tande consults, she says people have come to expect their income and standard of living to increase year over year—always. But with the recession, as salaries have stayed stagnant (at best), that is changing.

"Salary increase budgets have pretty much stayed the same now for a couple of years," she explains. "There are longer periods between increases, lower bonus pools or no bonus pools, longer times between promotions.

"Recently people have just been happy to have a job, so they are not necessarily expecting that they will improve their standard of living right now. If something positive could come from that, from my perspective, it would be that all the reductions—the layoffs, the takeaways, the high unemployment—would make a dent in the entitlement mentality."

Tande continues, "We talk a lot about pay for performance, but in general, we don't connect people to the idea that you get out of it what you put into it. When the company has a great year, employees expect more pay.

"But they don't really want to take the hit when the company does less. 'If we don't do so well, that was the economy or poor product. It wasn't really my fault, so I should still get mine.' That mentality starts at the top and trickles down."

Right now, employees don't necessarily expect an increase, providing an opportunity to start anew, Tande says. "This economy is an opportunity to think differently about pay for performance. If 'pay' is the cost piece, and 'performance' is the investment piece, we need to make sure we link them a little tighter.

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"Define what performance is, and manage the pay piece to more directly link it to performance that actually matters to the bottom line of the company. Pay out in a way that will help the company to improve the return on their human capital investment."

How? "Of course, if you have a great performer, give them the 4 percent increase, the bigger bonus, put them on the promotion list, let them attend seminars," Tande says. But maybe you should take a more sweeping look at your employees and identify those who stand out in a different way.

"What if we do better in identifying different kinds of performance? Some people might be very good at delivering results. They might not do it in the nicest possible way, but they deliver. Other people are good, steady performers, who are reliable when they are there, but they leave at 5:00. When they are there, they contribute to the overall culture and productivity of the unit; they can be relied upon; they are not always banging on your door asking for a raise; they are just happy to do their job.

"There are many different kinds of performance," Tande continues. "If you start looking at these categories differently, that would be one way you can better manage that 'cost' piece, combining it with the motivational, human capital piece of pay for performance."

Opportunity #2

Deemphasize base pay; emphasize variable pay. If there is only a small amount of money available for salary increases, Tande suggests granting more meaningful amounts to a smaller group of people, rather than very small increases across the board. Even better, use it as variable pay.

"Bonuses might not be big, but they might be a way to recognize the individuals who have stretched themselves particularly during the last performance period.

"You retain flexibility, because it's a one-time payment—you may not be able to pay it out next time, but you can do it now. If someone worked 80 hours a week to deliver a project on time and on budget, you can reward them without increasing base pay for something that may or may not happen again."

Opportunity #3

Use pay to communicate. "Every time you pay somebody a dollar that they didn't get before, you're communicating something," Tande says. "If you're paying them less than everybody else, you're communicating one message. If you're paying them more, you're communicating another.

"So get better at using each and every dollar, especially the fixed-cost dollars, by focusing them on performance, whether that's individual, group, team, or a combination.

"But deliver the money with a message. You have a time right now where people understand they may or may not get an increase—you have their attention. So next time you pay out a bonus, don't just send it out and hope they will understand what it's for.

"Our culture has a very short memory," she continues. "But we have a window open for the first time right now as companies are struggling. And this is when we have the time to link pay and performance.

"So the first time companies can really deliver an increase or a bonus again is that next communication opportunity. If they miss that window, they are not going to get it back again until we have another big downturn. I hope they will take it."

Opportunity #4

Get the house in order. A few years ago, it was understood that Baby Boomers would soon be leaving the workforce. That will still happen, says Tande, but the timeline has been pushed out a few years.

"That makes this the perfect time," she says "to get your house in order. If you're going to change your compensation program, not only do you have that window of opportunity, there is also less pressure on your recruiting function so you have time to make the changes.

"Some companies are saying that employees are easy to find, so why should they worry. I advise getting things in order now, or you're going to fall behind. This is the time to prepare."

How we want things and how they happen are often different. "But my hope would be that companies continue to think more carefully about how to spend their compensation dollars," Tande says.

"Blend together all the sexy theories around paying for performance, motivation, and driving behavior with compensation. Bring them together and be a little more discriminating in how you spend your money."

BLR's 2010 National Employment Law Update Conference

Business & Legal Resources, Inc., publisher of the newsletter, announces that its fourth National Employment Law Update conference will take place at The Venetian in Las Vegas October 27-29, 2010.

Attendees will receive updates from a slate of experts on new federal legislation, regulations, and court cases, as well as practical tips for reducing litigation risks. There will also be interactive workshops.

For more information on this event, please visit http://events.blr.com/nelu.

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Issued monthly. Subscription price: $298.00 annually for complete service. Periodicals postage paid at Old Saybrook, CT 06475-9998, Standard Mail enclosed.

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Fridays-Off Policy Is Favorite Summertime Perk for Employees

Who:	Friedman LLP
What:	Offers Fridays off in the summer.
Results:	Increased productivity and morale; low voluntary turnover

One of Friedman, LLP's best recruiting tools is a policy giving employees Fridays off during the summertime, according to Michael Gaines, Human Resources partner for the New York-based accounting, tax, and consulting services firm.

Pilot Proves Successful

From Memorial Day through Labor Day, all 325 staff members in Friedman's (www.friedmanllp.com) four offices in New York City, New Jersey, and Long Island may take Fridays off—without using vacation time, says Gaines.

Although their schedules can vary depending on team and client needs, employees typically work a 36-hour workweek during the summer, which generally translates to 9-hour workdays Monday through Thursday, he says. "We can be somewhat flexible with that." For example, employees can make arrangements with their manager to work late one night or to work from home on Fridays instead of extra hours spread throughout the week.

The Fridays-off policy was implemented during the summer of 2007, spearheaded by the managing partner of one of Friedman's offices and based on input from employees. He suggested that the firm roll out a pilot program and close one of its offices for the entire day on Fridays during the summer, Gaines explains. However, the partnership ultimately decided to try the new policy firmwide. "It was so successful that we've done it every year since 2007," he notes.

"The office is officially closed, but there are a few conditions, and they are very important," Gaines says. Friedman professionals who provide services to clients must maintain contact via technology on Fridays by forwarding their voice mail to their cell phones, checking e-mail and voice mail periodically throughout the day, and responding to client needs.

The firm did not formally announce its Fridays-off policy to clients. "We didn't want clients to be concerned that they would not get service on Friday," Gaines says, noting that most clients are aware of the policy anyway, but do not take issue with it.

The benefit has been well-received by employees. "I think it's been one of the best recruiting tools that we have," Gaines says, noting that when the firm announced the new perk after tax season in 2007, "there was a roar" of approval from employees.

He says the Fridays-off policy has helped increase productivity. "I think people work harder from Monday through Thursday to make sure they do not have to come in on Friday." He also credits this policy with helping the firm maintain an "extremely low" voluntary turnover rate and save on operational costs.

Other Popular Benefits

The Fridays-off policy was one of the benefits highlighted by *NJBIZ* when it recently recognized Friedman as one of the 55 Best Places to Work in New Jersey. However, the firm offers many employee perks throughout the year and special benefits during its busy tax-filing seasons from January through mid-April and from mid-August through mid-October.

Those benefits include ongoing professional development, tuition reimbursement, a weekday dinner allowance and free lunches on Saturdays during peak season, and a firmwide party—typically on the first Thursday after April 15—followed by Staff Appreciation Day the next day. "We give them the day off with our thanks," says Gaines.

From giving a $100 gift card to every employee both at the annual holiday party and on their birthday to free snacks throughout the year, "we do a lot of little things," he adds.

The firm also sponsors an annual, company-paid golf outing, which is open to Friedman staff members and select clients and referral sources (e.g., bankers, attorneys, and insurance agents). Friedman staff members participating in the golf outing must use a vacation day, and all participants must have "at least some idea of how to play golf. They don't have to be good," Gaines says.

In addition to receiving accolades from *NJBIZ*, Friedman was named earlier this year to *Accounting Today*'s 2009 Best Accounting Firms to Work For list and recognized as one of the Best Places to Work in New York City by *Crain's New York Business*.

What to Do

Employers interested in offering a Fridays-off policy might want to pilot a program using a shorter time frame (e.g., July 4 through Labor Day, the month of August), he says.

No matter what length of time you settle on, however, Gaines says the most important factor to ensure success is familiarizing all key managers with the policy and getting their buy-in for it.

If you do not have their support, they might take steps to ensure that the policy does *not* work, he says.

Gaines also recommends clearly outlining employees' responsibilities (e.g., the need to check their e-mail and voice mail on what is otherwise a day off from work).

Michael Gaines can be reached at mgaines@friedmanllp.com.

DOL Releases Final Child Labor Rules

The U.S. Department of Labor (DOL) recently issued final regulations updating protections for young employees in nonagricultural work. The regulations "protect young employees from dangerous machines and tools, excessive work hours, and other hazards at work," said Secretary of Labor Hilda L. Solis.

"These rules incorporate recommendations from the National Institute for Occupational Safety and Health and take a commonsense approach to keeping young workers safe from harm."

DOL now plans to focus its attention on "strengthening the regulatory protections for children working in agriculture," Solis said.

The rules, which are effective July 19, 2010, are available online at http://edocket.access.gpo.gov/2010/pdf/2010-11434.pdf.

Green Card Is Redesigned

The redesigned Permanent Resident Card, more commonly known as the "Green Card," incorporates several new security features aimed at deterring immigration fraud, according to a statement from the U.S. Citizenship and Immigration Services (USCIS).

Now colored green, the redesigned card will be issued to individuals recently approved for lawful permanent residency, as well as individuals seeking a renewal or replacement card. Existing cards without an expiration date will remain valid. However, USCIS is recommending that holders of such cards apply for a redesigned card.

Mandated Posting Of Employee Rights

Federal contractors and subcontractors must provide notice to employees of their rights under the National Labor Relations Act (NLRA), DOL explained in a new final rule implementing provisions of Executive Order 13496, which was signed by President Obama on January 30, 2009.

"This regulation, by requiring all covered federal contractors and subcontractors to post a notice in their workplaces, ensures their employees are aware of their rights under the National Labor Relations Act," said John Lund, director of DOL's Office of Labor-Management Standards. "Knowing their labor law rights leads to more stable labor-management relations and a more engaged workforce, which in turn facilitates greater efficiency and timely completion of federal contracts."

Form 5500 E-Signature Option

Starting this calendar year, retirement and welfare plans required to file an annual Form 5500 or 5500-SF must file electronically using DOL's Employee Benefits Security Administration's (EBSA's) EFAST2 electronic filing system. Now, the system has a new e-signature option, the EBSA recently announced.

Under this new option, service providers that manage the filing process for plans can get their own signing credentials and submit the electronic Form 5500 or 5500-SF for the plan. However, the service provider must confirm that it has written authorization from the plan administrator to do so; the administrator must manually sign a paper copy of the completed filing; and the service provider must attach of PDF of that manually signed copy as an attachment to the electronic filing, according to the EBSA.

Senate OKs Telework Bill For Federal Workers

Telecommuting opportunities for federal workers would be expanded under the Telework Enhancement Act of 2010 (S 707), which was recently approved by the U.S. Senate. "This winter's snowstorms highlighted the need to develop flexible work arrangements to make sure the government can function during disruptive events. The bill requires agencies to create telework policies and incorporate those policies into their continuity of operations planning," said Sen. Daniel K. Akaka (D-Hawaii), one of the bill's sponsors.

Meanwhile, a similar bill (H.R. 1722) was blocked by Republicans in the House of Representatives, said Rep. John Sarbanes (D-Maryland), who authored the legislation. However, the bill can be brought back to the floor in the future by a simple majority vote, he noted.

Sarbanes said teleworking helped the government save $30 million this winter, because some federal employees were able to work from home during snowstorms. He advocates expanding telework opportunities for federal workers.

IRS Update

Tax Credit Eligibility

The IRS recently issued Notice 2010-44 to help small businesses determine whether they are eligible for the new healthcare tax credit and, if so, how large a credit they will receive.

The guidance also clarifies that small employers receiving state healthcare tax credits may still qualify for the full maximum federal tax credit, and small businesses may receive the credit for add-on dental and vision coverage, in addition to regular health insurance.

The maximum credit—of up to 35 percent of employee health insurance premiums paid in 2010—is generally available to employers that have up to 10 full-time equivalent employees (FTEs), that pay annual average wages of up to $25,000, and that pay at least half the cost of single coverage for their employees this year, according to the IRS. The credit is completely phased out for employers that have 25 or more FTEs or that pay average annual wages of at least $50,000.

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Experts' Forum

Use Targeted Communications to Lower Costs and Improve Member Health

by Andy Roussel, Pitney Bowes Management Services

As rising healthcare costs eat away at an organization's bottom line, benefits managers look to: (1) reduce the cost of employee benefits, *and* (2) drive healthy outcomes by influencing member behavior. Communications can play a vital role in reaching these goals.

Communicating benefits is not merely sharing facts and figures, though. Instead, you should approach communications the way a marketer does, by using every tool available to influence behavior in the most cost-efficient way possible.

The real communications challenge is marketing the plan to program members and driving desired behaviors and outcomes. By thinking of every benefits challenge as a marketing problem, you can employ marketing practices to reduce communications complexity and plan costs, and drive healthy outcomes. This requires a well thought out, targeted communications program.

Marketing Practices At Your Disposal

Some marketing practices particularly useful in healthcare communications are:

- **Segmentation.** Segmentation analytics break down a population into groups so you can choose the messages that resonate most with each segment. Experience design uses experts to interpret member data to determine the best way to reach each audience segment and the best cadence, or frequency, of contact.
- **Location Intelligence.** Using segmentation tools along with Geographic Information Systems (GIS), you can relate data to geographic areas. Members need only receive information about participating pharmacies and Primary Care Providers (PCPs) in their area. This drives down printing, postage, and warehousing costs for those huge preprinted directories that are no longer necessary.
- **Differentiated Messaging.** A Variable Composition tool helps customize communications templates to specific audiences. One letter can be produced with different pictures for different targets. You can even tailor the language to the one spoken in the member's household.
- **Differentiated Multichannel Delivery.** Targeted marketing also helps effectively deploy the full range of communication channels, including texting, blogs, podcasts, social networks, and search, as well as traditional media. Hard copy printed materials still remain the dominant format for healthcare communications, as confirmed by a recent survey on healthcare benefit communications preferences. Print is particularly important in families, where options for coverage, care, and providers are shared with others. This preference for print also creates effective "transpromo" opportunities, such as a wellness message embedded in an Explanation of Benefits.
- **Response Evaluation.** You must monitor outcomes and adjust your communications tactics accordingly.

Real World Best Practices

Here's how targeted communications programs are deployed:

Increasing adherence. To increase member adherence to the treatment for a high-profile chronic illness, one organization identified both key challenges and solutions for its patient program. Next, a multichannel communications program was implemented that focused on the patient experience from on-boarding to ongoing benefits usage. This included: a differentiated approach by audience segment; differentiated messaging and channels based on the member's status in the relationship; a concerted effort to bridge gaps in the experience between the healthcare provider and patient; and a match-back approach to measure program impact.

The outcome: Initial registration targets more than doubled and the tiered, segmented patient experience, based on potential value, resulted in a lifetime cost reduction per patient of approximately 60 percent.

Replacing ER use with PCP visits. In a targeted program, as data is collected and analysis uncovers potential problems, remediation communications can guide members back to preferred practices. This "redirect marketing" requires ongoing usage monitoring and the flexibility to drive differentiated communications. One organization was experiencing significant challenges around some members' frequent use of the emergency room for primary care, an expensive approach.

The solution: Create a targeted enrollment mailing to the segment most likely to inappropriately use benefits. Location intelligence tools helped create mail pieces that listed the three participating PCPs closest to each member's home. Depending on family makeup, some mailings also included the three closest participating pediatricians and OB/GYN practices. The result: PCP visits increased 41percent.

Increasing preventive screenings. Another organization experienced poor participation in preventive care by new employees who needed guidance with the proper use of health benefits. The solution: a highly personalized and versioned mailing from the benefits services provider titled, "Why preventive care is important." This included an easy-to-follow "Guideline for maintaining your health" with individualized wellness guidance tailored to the age, gender, and specific needs of each family member.

As a result, wellness testing increased 25 percent. Also, the continued member dialogue put the benefits administrator in a position of trust and respect from which to steer desired behaviors and drive deeper engagements.

With help from targeted communications experts, tailored messaging in a targeted marketing program can dramatically increase healthcare program effectiveness while trimming costs.

Andy Roussel is director, Strategic Marketing, with Pitney Bowes Management Services (www.pb.com). He is responsible for solution strategies for three key vertical markets: insurance, financial services, and health care.

From the Courthouse

Court Imposes Fine for Inaccurate COBRA Notice

A federal bankruptcy court has assessed a statutory fine of $13,200 against an employer for backdating the qualifying event on the Consolidated Omnibus Budget Reconciliation ACT (COBRA) election notice provided to a terminated employee (*Olick v. Kearney*, U.S. Bankruptcy Court, Eastern District of Pennsylvania, No. 07-0052ELF and 07-0060ELF (12/28/2009)).

Facts. "Oz" began working an insurance salesperson for the Knights of Columbus in 1995 and was covered under the Knights' health insurance plan insured by Aetna. In late 2004 or early 2005, the relationship between Oz and his supervisor, "Keefe," began to sour. In September 2005, Keefe sent Oz a Notice of Intent to Terminate. The notice stated that Oz had failed to produce an acceptable volume of business to justify continued employment, and that unless he improved, he would be terminated on October 31.

In February 2006, Oz filed a suit in state court against the Knights and Keefe alleging age discrimination. When "Lex," the head of the Knights' agency department, heard about the suit, he checked Oz's personnel file and discovered that there was no record of any termination. Lex requested that Keefe prepare a termination form to terminate Oz. That same day, Keefe's office faxed to the agency department a termination form indicating January 1, 2006, as the effective date of Oz's termination.

Following discussions with Keefe and his supervisor, Lex ultimately decided to use November 1, 2005, as Oz's termination date. He later claimed that selecting November 1, 2005, as the effective date for Oz's termination was in Oz's best interest because it allowed Oz to receive refunds from any health insurance premiums, life insurance premiums, and computer service fees he paid between November and March 1, 2006.

The Knights sent Oz a COBRA Notice dated February 28, 2006, that used November 1 as the date of the qualifying event for Oz's termination of employment and as the date his health insurance was terminated. At the Knights' request, Aetna terminated Oz's health insurance coverage retroactively to that date.

Oz's suit continued through a long and convoluted legal process, and Aetna (that had been added as a defendant) eventually settled with him by reinstating Oz's coverage for the period of November 2005 through March 31, 2006. This left a number of claims, including the claim that the Knights had not provided a proper COBRA notice that made its way before a federal bankruptcy court.

Ruling. The judge first determined that Oz was an active Knights employee until February 28, 2006, when the Knights terminated his contract by sending him the termination form. The judge ruled that notice of the date of the qualifying event was crucial information and could not blithely be disregarded. The COBRA Notice advised Oz that his health benefits would terminate on November 1 unless he elected continuation coverage. The Notice should have stated that his health benefits would terminate as of February 28 unless he elected continuation coverage.

In making the decision whether to elect continuation coverage, the recipient of the COBRA Notice is entitled to accurate information regarding the consequences of electing or not electing coverage. A potential 4-month gap in health benefits coverage is material information that could have a substantial impact on the decision whether to elect continuation coverage and is a significant defect that warrants consideration of the imposition of discretionary statutory damages.

In deciding whether to assess statutory damages, courts have considered factors as bad faith or intentional conduct on the part of the administrator, the length of the delay, the number of requests made and documents withheld, and the existence of any prejudice to the participant or beneficiary. In this case, the judge decided the relevant considerations warranted an award of damages.

The incorrect statement of the date of the qualifying event did not result from an innocent clerical error. The use of a backdated qualifying event was the product of a considered choice by the Knights management

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The LAW

Where the employer is also the plan administrator, the employer has 44 days after a qualifying event to notify the qualified beneficiaries of the right to elect continuation coverage under COBRA (29 USC Secs. 1166(a)(2) and (a)(4)) and (29 CFR Sec. 2590.606-4(b)(2)). The qualified beneficiaries' election period (within which they may elect continuation of group health benefits coverage) begins when coverage terminates under the plan because of a qualifying event and ends 60 days after the date on which coverage terminates or the date on which the beneficiary receives notice of the right to elect COBRA continuation coverage, whichever is later.

ERISA provides employees and beneficiaries with a private cause of action against plan administrators who fail to provide the required notifications under COBRA. An administrator who fails to meet the notice requirements may be assessed $110 a day in damages from the date of the failure (29 USC Sec. 1132(c)).

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Benefits Corner

IRS 401(k) Questionnaire? Put Your Best Person on It

If you're the proud recipient of one of the 1,200 questionnaires recently sent to some 401(k) plan sponsors by the Internal Revenue Service (IRS), please don't assume that it's just routine and ask an inexperienced employee to complete it. Sandra Feingerts, a partner with Fisher & Phillips, LLP, worries that doing so could result in an audit of your plan. Why? Because previous experience says so.

This isn't the first time the IRS has mailed questionnaires out to a cross-section of plan sponsors. "The first time I remember seeing this kind of thing was in conjunction with universities," Feingerts says. The IRS was concerned with compensation being paid to high-level university employees and wanted to investigate how widespread the problem might be.

Questionnaires were sent to 400 tax-exempt colleges and universities asking about their practices. Following that 2008 questionnaire, the IRS recently announced that 30 of them would soon undergo thorough audits.

As mentioned at the outset, it would not be prudent to direct someone who doesn't possess sufficient knowledge and experience to take care of answering the questionnaire. "Some companies don't really have a benefits specialist; they have someone who is more of a jack-of-all-trades handling benefit questions. Be careful, because you don't want misinformation going on this questionnaire," says Feingerts.

"So if you happen to be one of the companies getting one of these, you should review it with legal counsel. Make sure you know how you're going to answer the questions. Go over them before you just start plugging answers into the computer and hitting the send button."

Why Are Plans Being Scrutinized?

Feingerts says enforcement activities may be on the rise, by both the IRS and the U.S. Department of Labor. "That might explain the timing of this questionnaire," she says. "For a number of years, this area has not had much attention from the agencies; there weren't a lot of audits initiated. I think there is concern that people have become sloppy with their plans."

In fact, that statement is made on the IRS website covering the questionnaire (www.irs.gov/retirement/article/0,,id=223440,00.html). There, the IRS clarifies that 401(k) plans, which make up 60 percent of the retirement universe, are thought to be less than perfect in their compliance with applicable laws and regulations.

"Employee Plans Examinations previously conducted a baseline study of 79 market segments, and the findings indicated that 401(k) plans are by far the most noncompliant plan type in the retirement plan universe," the website reports. "… it is important to the future of the private retirement system that these plans maintain the highest level of compliance possible."

If you receive the 401(k) questionnaire, you will have 90 days to complete the form, unless you request and receive an extension. Feingerts suggests using the form to help you identify potential compliance issues with your plan. Most compliance errors can be corrected using the IRS' Voluntary Correction Program (VCP) or by putting the plan in the position it would have been in if the error had not occurred, she says. Before taking that position, though, make sure the situation meets the requirements for correction without submission to the VCP.

IRS Questionnaire FAQs

Here are some of the most frequently asked questions about the 401(k) questionnaire, as noted on the IRS website:

Q: Why was my plan selected?

A: The 1,200 plans selected to receive this compliance check were selected at random from 401(k) plans that filed a Form 5500 for the 2007 plan year.

Q: Is this an audit?

A: This is a compliance check, which is neither an audit nor an investigation under IRC Section 7605(b) nor an audit under Section 530 of the Revenue Act of 1978. This is not a review of an organization's books and records.

Q: Am I required to respond to this compliance check?

A: Yes, a compliance check is an enforcement action which you must respond to. Failure to respond, or to provide complete information, will result in further enforcement actions which may include an examination of your plan.

ABOUT THIS NEWSLETTER

This newsletter is devoted to sharing compensation and benefits ideas that have worked for HR professionals striving to make a strategic difference in their companies.

If you have a story you'd like to share, send us a fax at 860-510-7224.

If you have a question about one of the newsletter stories or want more information, call 800-727-5257, ext. 2194, or e-mail equayle@blr.com.

CASE Study Study Study Study

Behavioral Finance and Your 401(k) Plan

Who: Anonymous company studied to determine participation rates before and after automatic enrollment was implemented

What: Implemented automatic enrollment in a 401(k) plan

Result: More than doubled the plan participation rate

Ever made a poor financial decision? If you're like the rest of us, you occasionally make a decision that baffles even you. You may sometimes wonder why your employees don't do things, like participating in the 401(k) plan, that are obvious ways to improve their financial well-being. Sheri Fitts, director of Communications and Large Plan Sales at The Standard, addressed the problem in a recent webinar about behavioral finance.

Most of the time, she explained, we believe that our decisions are based on rational, logical reasoning. And most of the time, that isn't the case. Human beings are very susceptible to subtle suggestions and emotion in our decision making. "We like to think that we're like Spock," she says, "but we just aren't."

Examining some common misconceptions about how we make financial decisions allows us to react with our heads instead of our hearts. If we extend the information to our employees, we can often encourage better financial decisions, especially in regard to the 401(k) plan.

Behavioral finance is thoroughly explained in some excellent books—Fitts particularly likes *Nudge: Improving Decisions About Health, Wealth and Happiness,* by Richard H. Thaler and Cass R. Sunstein (Penguin Books, 2008). In the interest of space, we'll include a few highlights and key concepts of behavioral finance here; you can view The Standard's webinar at http://tinyurl.com/35r2eqr to learn more.

Some of the basic principles of behavioral finance are *risk aversion, status quo bias, lack of self-control, and unrealistic optimism.*

Risk Aversion

We like to win, but we really hate to lose. Research repeatedly shows that people feel a loss about 2½ times more keenly than they feel a similar win.

Application: Employees presented with a choice of "losing" $125 per paycheck to the 401(k) plan may not sign up. But, if they are shown that they can accumulate $2,400 in a year toward their retirement, they may decide to enroll.

Status Quo Bias

OK, admit it: It's easier to do nothing than it is to do … well, anything. This means we are more inclined to stay where we are than to make any move, even when we know it's the best or the right thing to do.

Application: "Automatically enrolling employees in the 401(k) plan, or automatically increasing their contributions (with the ability to opt out, of course) results in a demonstrated increase in plan participation. It's just easier to go ahead and contribute 3% of pay than it is to take the steps to opt out," Fitts says.

The federal government, recognizing the principles of behavioral finance, paved the way for automatic enrollment with the Pension Protection Act of 2006. When certain conditions are met, plan sponsors may automatically enroll employees and automatically increase their contributions on a regular schedule.

The effect can be dramatic. In one company studied by researchers, the rate of participation among employees under the age of 65 went from 37.4% before automatic enrollment to 85.6% after.

But Fitts adds a word of caution. "Just because people participate in the plan doesn't mean they will take an active role in their participation," Fitts says. The same bias can also mean that participants continue at the minimal contribution rate and never take another look. "They can also assume that the automatic enrollment rate is your suggestion about how much they *should* be saving. More often than not, it is just a starting point, and you'll need to encourage them to save more."

The same study mentioned above demonstrated the effects of this bias. More than 70% of the automatically enrolled participants stayed at the 3% default contribution rate and in the money market default investment fund. A year later, half of them were still contributing just 3%, and 2 years later, 40%. "This is where communication can really help," Fitts says, "and so can automatic contribution increases."

Lack of Self-Control

You want to lose weight before summer really gets going, but you really want that chocolate cake. We don't need to tell you which one wins. The same thing applies to wanting to increase your clothing budget every month compared with saving more toward a distant retirement.

Application: Automatic enrollment can help here, too, by moving people past the decision point. The status quo bias kicks in, and they often think, "Oh well, I might as well stay in the plan."

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Unrealistic Optimism

When we don't know what the future holds, we often discount its importance. Researchers call this idea hyperbolic discounting, and it leads us to be irrationally optimistic. For example, a participant who is not in the 401(k) plan, or who is saving at a minimal rate, talks himself or herself into believing the retirement will take care of itself.

Application: Projection tools help employees see how their savings will accumulate. Realistic stories from actual plan participants and retirees illustrate the effects of saving enough—or not. In other words, communicate in an accurate and interesting way to help employees peer into the future.

Rules of Thumb

Behavioral finance defines several rules of thumb, or heuristics, commonly used in decision making. Fitts says some of them are *anchoring, availability,* and *representativeness.*

Anchoring. In essence, this is the idea that your starting point determines where you're comfortable. If you're working full-time, for example, you might be more comfortable moving to part-time employment than leaving the workforce entirely. The same can be said about contributing to a retirement plan. If you automatically enroll employees at 3% of pay and increase it 1% each year, they will be much more comfortable than if you asked them to enroll at 6% immediately.

Availability. If something has happened close to us and/or recently, we are much more likely to be able to call it to mind. "This becomes clear following an earthquake—especially a local one," says Fitts.

"Requests for earthquake insurance become much more common following the event and drop dramatically a few months later. You can use this in your retirement plan communications. Use real-life examples from your employee population to tell the story of how the retirement plan helps employees. Recent retirees can be examples of how saving (or not saving) makes a real difference in life-after-employment."

Representativeness. People tend to categorize, seeing patterns where none exist. If your favorite athlete is having a good season, you're likely to believe it will continue, and you may even put your money where your mouth is. When the stock market is on the rise, people invest at a higher rate than they do when it drops, even though the best bargains are available when the market is down.

Think about representativeness when educating employees about joining the plan; make sure they know the market is cyclical, and money invested when it is down can realize a much greater return.

Fitts recommends identifying thought leaders from among your employee population: those employees who seem to join everything and always know what's happening. "Other employees often look to these folks when making decisions," she says. "If you can encourage them to join the plan, you'll probably get higher participation rates and better contribution rates. Tell their stories in company newsletter articles, and encourage them to talk with their peers about it."

She also believes that framing is important. "It's all about context. How you say something may be even more important than what you say."

As mentioned, the idea of accumulating a decent sum at the end of 1 year is much more energizing than the idea of losing a smaller sum every payday. Always phrase the benefits of joining and contributing to the plan in positive terms.

While behavioral finance principles apply to all of us, there are things you can do to help employees overcome these natural tendencies. And if you do, you might help them realize a better retirement.

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Q: An employee is on military leave and is expected to be away for a year. We pay him the difference between his wages with us and his military wages. The HEART Act addresses payroll and income taxes on the differential, but we aren't clear as to whether it applies to the first 30 days. Can you clarify?

A: According to Joan S. Farrell, J.D., Legal Editor at BLR (publisher of this newsletter), the tax treatment does apply during the entire period, including the first 30 days of pay differential.

The Heroes Earnings Assistance and Relief Tax Act of 2008, also known as HEART, defines "differential wage payment" as any payment made by an employer with respect to any period during which the individual is performing service in the uniformed services on active duty for a period of more than 30 days, as long as the payment represents all or a portion of the wages the individual would have received from the employer if he or she were performing services for the employer.

If those conditions are met, the payments made *are* subject to income tax withholding, but are *not* subject to FICA or FUTA taxes.

The information is detailed on Rev. Ruling 2009-11 (www.irs.gov/pub/irs-drop/rr-09-11.pdf).

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Recession-Related Cost Cutting May Affect Employee Retention

Sometimes you may feel like the recession will never end. Of course, we all know the economy is cyclical, and one day you'll be desperately seeking new employees.

In its *2009/2010 U.S. Strategic Rewards Report—Looking Toward Recovery,* Towers Watson (in conjunction with WorldatWork) cautions that just how many employees you'll be hiring may depend in part on how you treat the ones you have now. "There has been a negative impact on some employee perceptions that could lead to higher attrition when the crisis is over," says the report.

Some of the key findings show that employees, particularly the top performers, may not be as happy just to have a job as you might believe. Most companies were forced to make cost-cutting changes during the recession, and employees understand that. But what the changes were, and how they were made, could have a detrimental effect on how employees view you as an employer. If they are unhappy, they are much more likely to jump ship when the recovery comes.

- Of the top performers, 20% fewer said they understand the link between the company's goals and their own than in 2008.
- In general, employees believe that cost-cutting measures taken by their employers are affecting their work quality and delivery to customers.
- 4-in-10 employees said the changes have adversely impacted quality and customer service, while only 17% of employers said the same.

These figures indicate that top-performing employees are at risk of taking a job at another company at their earliest opportunity.

The number who said they would recommend that someone else take a job at their current employer has declined by 20% in the last year. And, 22% are less confident now than a year ago that company leaders are doing the right things to bring the company back to growth and profitability. Overall, employees are 14% less likely to want to stay with their current employer than they were last year.

And once the recession runs its course, things are unlikely to return to prerecession "normal." One of the recommendations made in the report is that companies start now to identify and implement changes to their talent and reward management programs. Among the recommendations:

- If you had to cut salaries during the recession, reinstate them as quickly as is feasible.
- If possible, return merit pay budgets to pre-recession levels in 2010.
- Differentiate among top and average performers by basing merit increases on employee performance.
- Review your incentive pay metrics in light of modified business priorities, then communicate the changes.
- Take a look at career development and performance management programs, making sure they align with the new business landscape.
- If funding remains below targets for bonus compensation, make sure employees understand how their performance impacts their bonus.

Employers Pessimistic About Healthcare Reform Savings

Ironically, the foremost goal among employers for healthcare reform was cost-containment, yet 88% of them believe the Patient Protection and Affordable Care Act (PPACA) will actually *increase* healthcare costs. That's according to a recent report from Towers Watson, which surveyed more than 650 mid- to senior-level benefits professionals and asked them what they believe the impact of reform will be.

Even while most respondents believe costs will increase, 88% of surveyed employers reported that they will either "definitely" or "likely" continue to provide healthcare coverage to their employees, rather than dropping it in favor of paying penalties.

At the same time, 85% of the survey respondents said that healthcare reform will reduce the number of large companies offering health insurance coverage to retirees. If higher costs do result from the PPACA, 88% said they will pass the increases along to employees, and 74% said they will reduce health benefits and programs.

According to the report, the excise tax on so-called "Cadillac plans" may sneak up on some firms. Towers Watson reports that 46% of employers believe they will be subject to the excise tax. However, their data suggest that it will actually apply to more than 60% of employers when it becomes effective in 2018, and many more in subsequent years.

The second and third priorities employers sought from healthcare reform were encouraging healthy lifestyles for their employees, and improving quality of care. There is a little more optimism on these fronts: 82% of respondents said they remain committed to fostering a culture of health by continuing their health improvement and wellness initiatives.

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and was not the product of a good-faith belief that Oz resigned on November 1. It was wholly unjustified, the judge determined, and resulted from animus directed against Oz.

The judge concluded that quantifying the damage award at $13,200 was appropriate and sufficient because Oz already has been compensated for the actual damages he suffered as a result of the backdating of the qualifying event, the medical expenses incurred between November 1 and February 28 had been covered, and the monetary liability for the COBRA violation would be only a portion of the financial impact the litigation would have on the Knights.

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Violating Salary Basis Test Entitles Exempt Employees to OT

The Fair Labor Standards Act (FLSA) permits employers to treat "any employee employed in a bona fide executive, administrative, or professional capacity" as exempt from FLSA's minimum wage and overtime requirements *provided* such employees are being paid on a "salary basis."

Regulations to the FLSA provide that an employee is being paid on a salary basis if the employee "regularly receives each pay period on a weekly, or less frequent basis, a predetermined amount constituting all or part of the employee's compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed (20 CFR 541.602(a))."

When the issue of whether an employer actually complied with the salary basis test gets to court, the burden of proof is on the employer to prove compliance, and courts will narrowly construe the requirements of the test against the employer unless the employer can prove it was plainly and unmistakably acting within the terms and spirit of FLSA regulations. If the employer can't prove this, it loses the right to treat the employees as exempt during the periods in which improper deductions from salary were made (29 CFR 541.603(b)).

FLSA regulations provide some aid to the employer by providing a so-called "window of correction" because of salary deductions taken by mistake. The regulations provide that "improper deductions [from salary] that are either *isolated or inadvertent* will *not* result in loss of the exemption [from minimum wage and overtime] for any employees subject to such improper deductions, if the employer reimburses the employees for such improper deductions (see 29 CFR 541.603(c))." [Emphasis supplied]

A recent case from a U.S. district court sitting in New York illustrates that this window of correction can slam shut all too easily on the employer that brazenly, or out of plain ignorance of the law, fails to comply with the salary basis test. Forty-four current and former employees commenced a class action suit against the employer for unpaid overtime, alleging that the employer, that properly complied with the "duties test" in classifying them as professionals, violated the salary basis test and therefore owed them overtime.

What Happened

The employer was the Eldre Corporation (court records don't indicate its location or the nature of its business). As to what actually were the payment practices of Eldre that led to the employees' class action suit for unpaid overtime, it depends on whether you believe the employees or Eldre. One thing was not in dispute: The employees who commenced this class action against Eldre were properly classified as exempt professional employees. In other words, the duties test set forth in the regs was satisfied: Their primary duties consisted of work requiring advanced knowledge in a field of science or learning customarily acquired by a prolonged course of study.

Another thing not in dispute was that employees did work over 40 hours per week, since Eldre's handbook for exempt employees stated that a "salaried employee is required to work 45 hours per week on the basis of 9 hour minimum work days, Monday through Friday." Under the FSLA, an employee who works more than 40 hours per week must receive time and a half for overtime unless the employee is exempt (i.e., the duties *and* salary basis test is satisfied).

What *was* in dispute was whether Eldre violated the salary basis test. The employees asserted that it had, because, among other things, from 1998 up until 2004, Eldre engaged in the practice of docking the salaries of exempt employees for partial-day absences: If an ostensibly salaried employee missed part of a day, the employee was not paid for the time that she or he was absent.

The employees asked for summary judgment, as a matter of law, on this issue. Eldre also asked for summary judgment on this issue and argued that even if the alleged deductions were made, they were "isolated or inadvertent" under the language of the window of corrections.

What the Court Said

The court granted the employees' motion for summary judgment as a matter of law with respect to Eldre's alleged practice of docking the salaries of exempt employees for partial-day absences. The court was persuaded by the depositions of Eldre's current human resources manager and her predecessor, which clearly stated that under an unwritten company policy, Eldre, over a 6-year period, infrequently made deductions from exempt employees' salaries because of such employees' partial-day absences, a practice that Eldre discontinued in 2004 (about 6 months before these depositions were taken). The court held that these deductions were evidence "that establishes as a matter of law that there was an actual practice of making such deductions."

The court held that Eldre could not avail itself of the window of corrections, which excuses isolated or inadvertent deductions from salary. The court stated, "The purpose of the window of correction is to allow employers to correct, and thereby avoid liability for, violations that are the result of a mistake, not due to company policy." The court held that even if Eldre's deductions were infrequent, the evidence showed that there was still an actual company policy in that regard; the deductions were not purely the result of some mistake or inadvertence.

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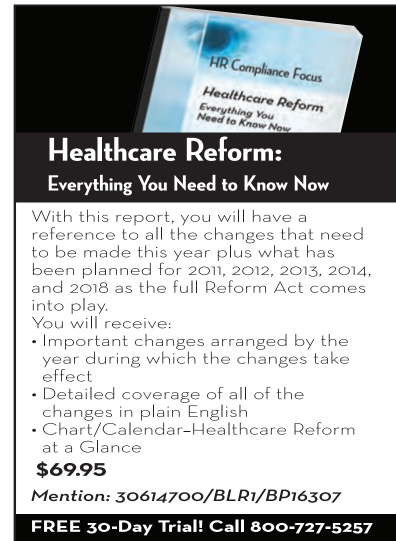
With respect to the amount of actual damages owed to the employees, however, the court noted that on the record before it, "the Court cannot determine as a matter of law during what periods these improper deductions did occur, the extent to which they occurred, exactly which employees or job classifications were affected by the practice, or the number of hours for which plaintiffs are entitled to overtime pay. The amount of damages therefore remains to be decided."

So in a subsequent proceeding, the employer will have to produce good records of its prior payroll practices for the years in question if it hopes to refute any claims of employees that it believes are slightly exaggerated. *Scholtisek v. Eldre Corporation*, U.S. District Court for the Western District of New York, No. 03-CV-6656L (2010)

Point to Remember

An exempt, salaried employee must be paid the same amount each pay period. Docking the pay of such an employee may make the employee no longer exempt.



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By the numbers…

	Latest Period	Current	Prior Report	A Year Ago	12-Month % Change
CPI-U	May/10	218.2	218.0	213.9	2.0%
CPI-W	May/10	214.1	214.0	208.8	2.6%
ECI EMPLOYMENT COST INDEX					
Total Compensation	1Q/10	111.1	110.2	109.3	1.6%
Wages and Salaries—Private Industry	1Q/10	111.4	110.9	109.8	1.5%
Wages and Salaries—Civilian Workers	1Q/10	111.7	111.2	110.0	1.5%
Benefits—Private Industry	1Q/10	110.4	108.8	108.2	2.0%
Average Weekly Gross Wages*	May/10	$636.17	$632.93	$614.01	3.6%
Average Hourly Wages					
All*	May/10	$18.99	$18.95	$18.55	2.4%
Construction	May/10	$23.10	$23.07	$22.63	2.1%
Manufacturing	May/10	$18.57	$18.50	$18.15	2.3%
Trade/Transp./Utilities	May/10	$16.86	$16.83	$16.45	2.5%
Wholesale Trade	May/10	$21.56	$21.51	$20.86	3.4%
Retail	May/10	$13.19	$13.20	$12.96	1.8%
Financial Activities	May/10	$21.42	$21.36	$20.79	3.0%
Other Services	May/10	$16.79	$16.78	$16.50	1.8%
Unemployment Rate*	May/10	9.7%	9.9%	9.4%	0.3%

*seasonally adjusted
(**Source:** Bureau of Labor Statistics, Washington, D.C.)
All figures are national.

CPI-U: Consumer Price Index for all urban consumers; the newer index representative of the buying habits of about 87% of the total U.S. population. (1982–84=100)

CPI-W: Consumer Price Index for urban wage earners and clerical workers; the older index covering only about 32% of the U.S. urban population.

ECI: Measures change in compensation per hour worked, including wages, salaries, and employer costs of benefits. (6/89=100)

Average Weekly Gross Wages and Average Hourly Wages: Data related to production workers in manufacturing and mining; construction workers; nonsupervisory workers in transportation, public utilities, and wholesale/retail trade; also finance, insurance, real estate, and other services. Accounts for approximately 80% of the total employees on private, nonfarm payrolls.

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