



## CHAPTER 15

# Managing Employee Benefits

*After you have read this chapter, you should be able to:*

- Define what a benefit is and identify two strategic reasons why employers provide benefits.
- Distinguish between mandated and voluntary benefits and list three examples of each.
- Describe two security benefits.
- List and define at least six pension-related terms.
- Explain why health-care cost management has become important and identify some methods of achieving it.
- Discuss why family-oriented and time-off benefits have grown in importance to many employees.
- Discuss benefits communication and flexible benefits as considerations in benefits administration.

## HR TRANSITIONS

# Competing with Employee Benefits

In competing for workers, many employers are offering their employees a wide range of benefits other than those considered standard. Food services, counseling services, paid professional memberships, uniforms, and employee discounts are common. But some other employers offer more unusual benefits, as the following examples illustrate:

- At Autodesk, employees can have dry cleaning picked up and delivered to their desks.
- At some locations of Barnett Banks in Florida, employees can arrange for car washes.
- At Netscape Communications a dental van comes to the office complex twice a week and dentists perform root canals, teeth cleaning, and other general dental services.
- On his or her birthday, each employee at Mary Kay Cosmetics in Dallas, Texas, receives a birthday card and a coupon for a free lunch or movie tickets for two. After five years with the company, employees receive a \$100 U.S. Savings Bond.
- At Con Agra's frozen food division in Omaha, Nebraska, an employee who has a sick child can request that a trained babysitter go to the employee's house so that the employee can go to work. Con Agra pays 75% of the cost for the "sick kid" sitter.

Organizations are offering such benefits in order to retain employees using means not readily available elsewhere. These organizations hope to create greater employee loyalty, which will enhance employee retention. They also hope that offering unusual benefits will help differentiate them when

recruiting workers, particularly professionals and managers who have scarce skills. An employer with a more attractive benefits package may have an advantage over other employers in hiring qualified employees if the base pay is similar to that of competing firms. In fact, such benefits may create "golden handcuffs," whereby employees may be more reticent to move to another employer.

In traditional organizational environments, most workers are full-time employees who have a high degree of job security and comprehensive benefits plans. However, in many organizations today, a large percentage of workers are part-time or con-

tingent workers. Many workers, especially those with capabilities that are in high demand, leave jobs after one or two years. Organizations are "rightsizing" some people out of jobs, while they continue to hire others. Consequently, employees are looking for benefits that they can move from employer to employer and manage themselves. The rapid growth of 401(k) plans, in which employees and employers both contribute to funding of retirement benefits, illustrates this change to greater individual employee responsibility. Even part-time workers are sometimes participating in benefits programs, doing so in proportion to the

percentage of full-time equivalent hours worked.

The benefits offered also are expanding to reflect changes in employee lifestyles and demographics. Due to the aging of the population, long-term care insurance is being added by some employers. According to a study by Hewitt Associates, a growing number of employers will be offering the opportunity for employees to purchase long-term care insurance. Providing employees benefits more often purchased individually also is seen as the way to save employees time and money, while costing the employers little.

Employees with family responsibili-

*An employer with a more attractive benefits package may have an advantage over other employers in hiring qualified employees if the base pay is similar to that of competing firms.*

ties see both child-care and elder-care benefits as valuable. On-site child-care centers, elder-care referral networks, alternative work schedules, and telecommuting are just some of the benefits options available to assist employees attempting to balance work and family demands.

From the employers' perspective, employee benefits are a double-edged sword. On one side, employers are trying to cut costs, or at least restrain the growth of benefit costs. On the other side, employers are learning that in order to attract and retain employees with the necessary capabilities means that employers will have to offer more and varied benefits.

“In this era of greater personal responsibility and demographic changes, government, employers and individuals are changing their approaches to financial security and how it can be maintained through employee benefits.”

ANNA M. RAPPAPORT

### Benefit

An indirect reward given to an employee or group of employees as a part of organizational membership.

Employee benefits are available in a smorgasbord of indirect compensation, such as pensions, health insurance, time off with pay, and many others. A **benefit** is a form of indirect compensation. Unlike employers in many other countries, employers in the United States have become a major provider of benefits for citizens. In many other nations, citizens and employers are taxed to pay for government-provided benefits such as health care and retirement. Although U.S. employers are required to provide some benefits, they voluntarily provide many others.

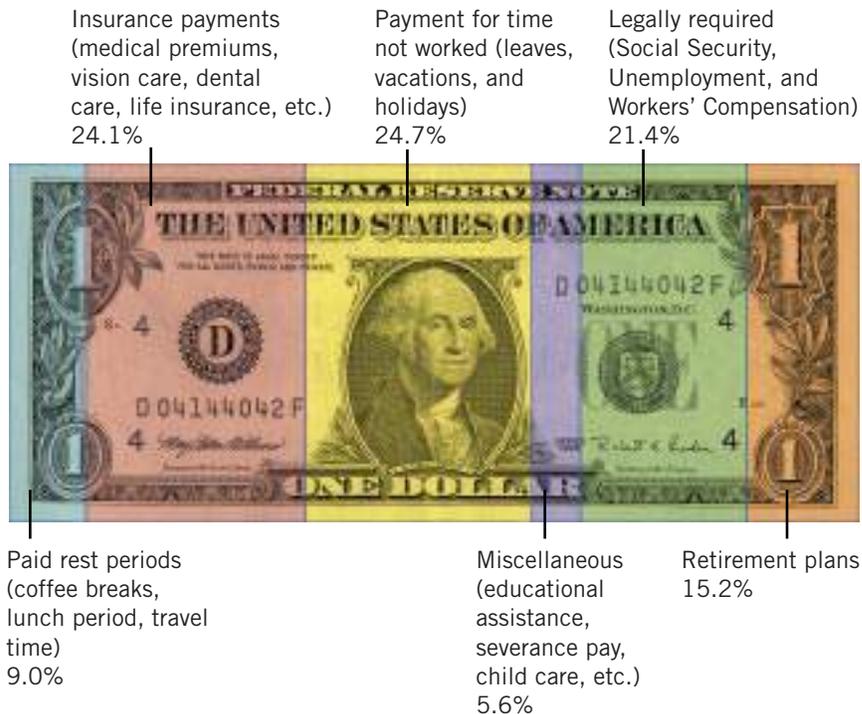
Benefits must be viewed as part of the total compensation package offered to employees. Total compensation includes money paid directly (such as wages and salaries) and money paid indirectly (such as benefits). Too often, both managers and employees think of only wages and salaries as compensation and fail to consider the additional costs associated with benefits expenditures.

Total labor compensation amounts to over half of all total costs at many employers' operations and even more in some service operations. For example, around 80% of the U.S. Post Office budget is labor compensation. Because all of the compensation components of base pay, variable pay, and benefits are such a significant part of organizational cost, it is important that these costs be viewed realistically.

The scope of benefits costs is seen in Figure 15–1. According to a study by the U.S. Chamber of Commerce, employer spending on benefits equals 41.39% of overall payroll costs.<sup>2</sup> Using data from the Chamber of Commerce survey, average employee's annual base pay is \$29,371, and that “average” employee has benefits totaling \$14,086 added to the base pay. This results in a total average annual cost of \$43,457 for that typical employee. In manufacturing industries, the total annual individual benefits expenditure averages over \$19,000; in non-manufacturing industries, the average is about \$13,000. Figure 15–1 shows how the average benefit costs are divided. Notice that payments for time not worked, insurance payments, and legally required payments compose about 70% of the total benefits expenditures.

## Strategic Perspectives on Benefits

Increasingly, employers consider benefits and the expenditures associated with them as linked to organizational strategic goals.<sup>3</sup> This linkage is especially true as one considers some of the changing demographics affecting organizations and their implications in employee benefit plans. First, employers must offer competitive compensation packages if they are to compete in the tight labor markets present in many geographic locales and occupational fields. Second, the aging of the workforce places greater demands on employers to monitor the costs associated with health-care and retirement-related benefits plans. Additionally, with more dual-career couples and single-parent families, the benefits associated with

**FIGURE 15-1** *How the Benefit Dollar Is Spent*

SOURCE: Based on information in *Employee Benefits*, 1997 edition (Washington, DC: U.S. Chamber of Commerce, 1997).

work and family issues—such as family leaves, working schedules, and dependent care—are having to be addressed daily by HR professionals.

## Nature of Benefits

Benefits attempt to protect employees and their dependents from financial risks associated with illness, disability, and unemployment. Also, as discussed at the beginning of the chapter, from management's perspective benefits are thought to contribute to attracting, retaining, and maintaining human resources. Two factors that have influenced the growth of benefits are federal tax laws and other legislation affecting benefits.

**TAX ADVANTAGES OF BENEFITS** Benefits generally are not taxed as income to employees. For this reason, they represent a somewhat more valuable reward to employees than an equivalent cash payment. For example, assume that employee Henry Schmidt is in a 25% tax bracket. If Henry earns an extra \$400, he must pay \$100 in taxes on this amount (disregarding exemptions). But if his employer provides prescription drug coverage in a benefit plan, and he receives the \$400 as payments for prescription drugs, he is not taxed on the amount; he receives the value of the entire \$400. This feature makes benefits a desirable form of compensation to employees, and more benefits are more desirable.



### LOGGING ON . . .

#### The Benefits Link

This website is an Internet link to information and services for employers and employees regarding benefit plans, products, services, and job opportunities in benefits. It also offers a benefits search engine for specific inquiries.

<http://www.benefitlink.com/index.shtml>

**FEDERAL SOCIAL LEGISLATION AND BENEFITS** A variety of laws, from the Social Security Act to the Family and Medical Leave Act (FMLA), have required that certain employers provide benefits to certain employees. These laws are covered later in this chapter. The number and total cost of mandated benefits have increased over the years, causing the total cost of keeping employees on the job to increase as well, even for employers who offer no voluntary benefits. As a result, a growing number of employers show a preference for having existing employees work overtime, rather than hiring new employees, in an attempt to save on such benefit costs.

## Evaluating Benefits Strategically

As with any expenditure, it is important that a strategic evaluation of benefits expenditures be done. Given the significant dollars spent on benefits by many employers, HR professionals are the ones who must provide “cost-benefit” analyses on benefits. As part of their evaluative efforts, HR professionals should address a number of strategic concerns about benefits:

- What is expected from benefits?
- What is an appropriate mix of benefits?
- How much total compensation, including benefits, should be provided?
- What part should benefits comprise of the total compensation of individuals?
- What expense levels are acceptable for each benefit offered?
- Why is each type of benefit offered?
- Which employees should be given or offered which benefits?
- What is being received in return for each benefit?
- How does having a comprehensive benefits package aid in minimizing turnover or maximizing recruiting and retention of employees?
- How flexible should the package of benefits be?

## Types of Benefits

Many different types of benefits are offered by employers. As Figure 15–2 indicates, some of the benefits are legally mandated by federal, state, and local laws. Employers have little choice but to pay for these benefits.

### Mandated benefits

Those benefits which employers in the United States must provide to employees by law.

**MANDATED BENEFITS** **Mandated benefits** are those benefits which employers in the United States must provide to employees by law. Social Security and unemployment insurance are funded through a tax paid by the employer based on the employee’s compensation. Workers’ compensation laws exist in all states. In addition, under the Family and Medical Leave Act (FMLA), employers must offer unpaid leaves to employees with certain medical or family difficulties. Other mandated benefits are available through Medicare, which provides health care for those age 65 and over. It is funded in part by an employer tax through Social Security. The Consolidated Omnibus Budget Reconciliation Act (COBRA) and the Health Insurance Portability and Accountability Act (HIPAA) mandate that an employer extend health-care coverage to employees after they leave the organization, and that most employees be able to obtain coverage if they were previously covered in a health plan.

**FIGURE 15–2** *Benefits Classified by Type*

Government Mandated	Employer Voluntary	
<b>Security</b>	<b>Health Care</b>	<b>Family-Oriented</b>
Workers' compensation	COBRA and HIPAA provisions	Family and Medical Leave Act
Unemployment compensation	Medical	Dependent care
Supplemental unemployment benefits (SUB)	Dental	Alternative work arrangements
Severance pay	Vision care	<b>Time Off</b>
<b>Retirement Security</b>	Prescription drugs	Military reserve time off
Social Security	Psychiatric counseling	Election and jury leaves
Early retirement options	Wellness programs	Lunch and rest breaks
Pre-retirement counseling	HMO or PPO health-care plans	Holidays and vacations
Disability retirement benefits	<b>Financial, Insurance and Related</b>	Funeral and bereavement leaves
Health care for retirees	Life insurance	<b>Social and Recreational</b>
Pension plans	Legal insurance	Tennis courts
Individual retirement accounts (IRAs)	Disability insurance	Bowling leagues
401(k) and 403(b) plans	Financial counseling	Service awards
	Credit unions	Sponsored events (athletic and social)
	Company-provided car and expense account	Cafeteria and food services
	Educational assistance	Recreation programs

Mandated benefits have been *proposed* for many other areas, but as yet none of the proposals have been adopted. Areas in which coverage has been proposed are as follows:

- Universal health-care benefits for all workers
- Child-care assistance
- Pension plan coverage that can be transferred by workers who change jobs
- Core benefits for part-time employees working at least 500 hours per year

A major reason for these proposals is that federal and state governments want to shift many of the social costs for health care and other expenditures to employers. This shift would relieve some of the budgetary pressures facing governments to raise taxes and cut spending.

**VOLUNTARY BENEFITS** Most of the other types of benefits are provided by employers voluntarily in order to compete for and retain employees. By offering additional benefits, organizations are recognizing the need to provide greater security and benefit support to workers with widely varied personal circumstances. By offering more benefits, employers hope to strengthen the ties between the organizations and employees as valuable human resources. Also, as the workforce ages and more individuals retire, financial security in retirement is an issue that employees and employers are addressing. In addition, with the changes in work and jobs emphasizing flexibility and choice, both workers and employers are seeing benefits choices as necessary. As a result, flexible benefits and cafeteria benefit plans have expanded. The following sections describe the different types of benefits that were shown in Figure 15–2.

## Security Benefits

A number of benefits provide employees security. Some of these benefits are mandated by laws, while others are offered by employers voluntarily. Workers' compensation, unemployment compensation, and severance pay are primary benefits existing in most organizations.

### Workers' Compensation

#### Workers' compensation

Benefits provided to persons injured on the job.



#### LOGGING ON . . .

##### Workers' Compensation

This site contains a library of current and archived articles about workers' compensation. It also provides links to other websites about workers' compensation.

<http://www.complink.com/>

**Workers' compensation** provides benefits to persons injured on the job. State laws require most employers to provide workers' compensation coverage by purchasing insurance from a private carrier or state insurance fund or by providing self-insurance. Employers that self-insure are required to post a bond or deposit securities with the state industrial commission. State laws usually require that employers have a minimum number of employees before they are permitted to self-insure. Group self-insurance is permitted in some states and is useful for groups of small businesses. U.S. government employees are covered under the Federal Employees' Liability Act, administered by the U.S. Department of Labor.

**WORKERS' COMPENSATION REQUIREMENTS** The workers' compensation system requires employers to give cash benefits, medical care, and rehabilitation services to employees for injuries or illnesses occurring within the scope of their employment. Employees are entitled to quick and certain payment from the workers' compensation system without proving that the employer is at fault. In exchange, employees give up the right of legal actions and awards; so employers enjoy limited liability for occupational illnesses and injury.

**CONTROLLING WORKERS' COMPENSATION COSTS** Workers' compensation costs have increased dramatically in the past and have become a major issue in many states. These costs comprise from 2% to 10% of payroll costs for most employers. Major contributors to the increases have been higher litigation expenses and medical costs.

Employers continually must monitor their workers' compensation expenditures.<sup>4</sup> To reduce accidents and workers' compensation costs, an employer should have a well-managed safety program, which typically results in: (1) reduction in insurance premiums, (2) savings of litigation costs, (3) fewer wages paid for lost time, (4) less expense in training new workers, (5) less overtime, and (6) greater

productivity. Efforts to reduce workplace injuries and illnesses can reduce workers' compensation premiums and claims costs. Many of the safety and health management suggestions discussed in Chapter 16 can be used to reduce workers' compensation costs.

## Unemployment Compensation

Another benefit required by law is unemployment compensation, established as part of the Social Security Act of 1935. Each state operates its own unemployment compensation system, and provisions differ significantly from state to state.

Employers finance this benefit by paying a tax on the first \$7,000 (or more, in 37 states) of annual earnings for each employee. The tax is paid to state and federal unemployment compensation funds. The percentage paid by individual employers is based on "experience rates," which reflect the number of claims filed by workers who leave. An employee who is out of work and is actively looking for employment normally receives up to 26 weeks of pay, at the rate of 50% to 80% of normal pay. Most employees are eligible. However, workers fired for misconduct or those not actively seeking employment generally are ineligible.

**CRITICISM OF UNEMPLOYMENT INSURANCE** Changes in unemployment insurance laws have been proposed at both state and federal levels, for two reasons: (1) Abuses are estimated to cost billions each year, and (2) many state unemployment funds are exhausted during economic slowdowns. Some states allow union workers who are on strike to collect unemployment benefits, a provision bitterly opposed by many employers.

**SUPPLEMENTAL UNEMPLOYMENT BENEFITS (SUB)** Supplemental unemployment benefits (SUB) are closely related to unemployment compensation, but they are *not required by law*. First obtained by the United Steelworkers in 1955, a SUB program is a benefit provision negotiated by a union with an employer as part of a collective bargaining agreement. The provision requires organizations to contribute to a fund that supplements the unemployment compensation available to employees from federal and/or state sources.

## Severance Pay

**Severance pay** is a security benefit voluntarily offered by employers to employees who lose their jobs. Severed employees may receive lump-sum severance payments if their employment is terminated by the employer. For example, if a facility closes because it is outmoded and no longer economically profitable to operate, the employees who lose their jobs may receive lump-sum payments based on their years of service. Severance pay provisions often appear in union/management agreements and usually provide larger payments for employees with longer service. Figure 15–3 on the next page depicts a study of severance practices in the health-care industry. Notice that senior-level executives typically receive more severance per year of service than do lower-level managers and employees.

Many employers have begun reducing the amount of cash severance given, but replacing some of the severance value by offering continued health insurance and outplacement assistance.<sup>5</sup> With *outplacement* assistance ex-employees receive resume-writing instruction, interviewing skills workshops, and career counseling.

### **Severance pay**

A security benefit voluntarily offered by employers to employees who lose their jobs.

**FIGURE 15-3 Severance Pay in the Health-Care Industry**

Calculation of Severance	Percent of companies giving each amount of severance pay						
	President, CEO, COO	Senior Execs: CFO Vps, etc.	Dept Heads & Mgrs	Physicians	Supervisory/ Technical	Other Primary Care Personnel	Maintenance/ Housekeeping
Less than 1 week/year of service	8	7	6	13	10	11	12
1 week/year of service	33	31	48	50	65	70	70
2 weeks/year of service	13	16	28	20	16	15	14
3 weeks/year of service	4	4	3	0	1	1	1
1 month/year of service	26	29	12	13	5	2	2
Over 1 month/year of service	17	13	3	4	3	1	1

\*Column percentages do not total 100% due to multiple answers by respondents.

SOURCE: *Severance Practices in the Health-care Industry* (Philadelphia: Right Management Consultants, 1997), 25. Used with permission.

The Worker Adjustment and Retraining Notification Act (WARN) of 1988 requires that many employers give 60 days' notice if a mass layoff or facility closing is to occur. The act does not require employers to give severance pay.

## Retirement Security Benefits

Few people have financial reserves to use when they retire, so retirement benefits attempt to provide income for employees who have retired. Except for smaller employers with fewer than 100 employees, most employers offer some kind of retirement plan. Generally, private pensions are a critical part of providing income for people after retirement. With the baby boomer generation closing in on retirement, pressures on such funds are likely to grow.

### Retirement Benefits and Age Discrimination

As a result of a 1986 amendment to the Age Discrimination in Employment Act (ADEA), most employees cannot be forced to retire at any age. As a result, employers have had to develop different policies to comply with these regulations. In many employer pension plans "normal retirement" is the age at which employees can retire and collect full pension benefits. Employers must decide whether individuals who continue to work past age 65 should receive the full benefits package, especially pension credits. As possible changes in Social Security increase the age for full benefits past 65, these policies likely will be modified. Despite the removal of mandatory retirement provisions, the age at which individuals retire has continued to decline in the United States. About 75% of all workers retire before the age of 65 years.<sup>6</sup>

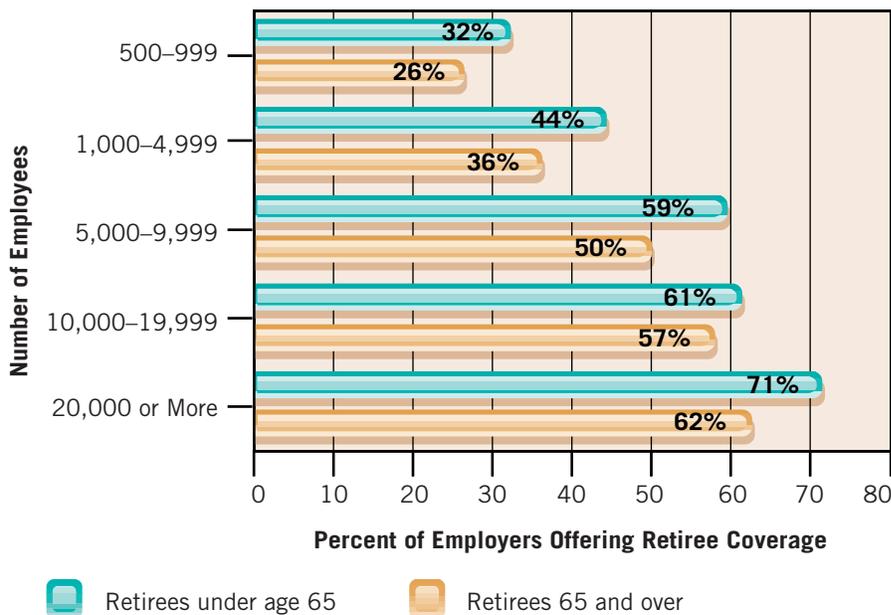
**EARLY RETIREMENT** Provisions for early retirement currently are included in many pension plans. Early retirement gives people an opportunity to get away from a long-term job; individuals who have spent 25 to 30 years working for the same employer may wish to use their talents in other areas. Phased-in and part-time retirements also are used by some individuals and firms.

Some employers use early retirement buyout programs to cut back their workforces and reduce costs. Care must be taken to make these early retirement programs truly voluntary. Forcing workers to take advantage of an early retirement buyout program led to the passage of a federal law entitled the Older Workers Benefit Protection Act (OWBPA).

**OLDER WORKERS BENEFIT PROTECTION ACT (OWBPA)** Passed in 1990, the Older Workers Benefit Protection Act (OWBPA) amended the ADEA and overturned a 1989 decision by the U.S. Supreme Court in *Public Employees Retirement System of Ohio v. Betts*.<sup>7</sup> This act requires equal treatment for older workers in early retirement or severance situations. It sets forth some very specific criteria that must be met when older workers sign waivers promising not to sue for age discrimination.

**RETIREE BENEFITS** Some employers choose to offer their retirees benefits, which are paid by the retirees, the company, or both. These benefits are usually available until the retiree is eligible for Medicare. Figure 15–4 shows the retiree health-benefit coverage by employer size. The costs of such coverage have risen dramatically, and to ensure that firms adequately reflect the liabilities for retiree health

**FIGURE 15–4 Retiree Health Benefits by Employer Size**



SOURCE: Based on data from Foster Higgins, as appearing in *1998 Benefits Sourcebook, Employee Benefits News*, 1998, 22. Used with permission.

## HR PERSPECTIVE

## Ethics of Cutting Retiree Benefits

For many retirees the pension and health-care benefits provided by their former employers are the core of their retirement security, both financial and emotional. At the same time, pension benefits and retiree health-care costs represent major expenses and/or a source of additional savings for employers. The two perspectives raise a serious question: *How ethical is it for a firm to cap or cut the pensions and health-care benefits provided to retired former employees?*

Many of the retirees worked for their employers for twenty, thirty, forty, or more years. Yet for retirees from some employers, the reward for long and loyal service increasingly is a reduction in benefits. Employers have tried to combat rising costs by trying such strategies as the following:

- Canceling retiree health-care benefits, especially if the retiree

takes another job offering some benefit coverage, even if the job is part-time.

- Restricting retirement benefits for current retirees by raising deductibles, cutting coverage, or reducing employer contributions.
- Changing retiree health benefits to require retirees to switch to managed health-care programs such as HMOs.
- Lobbying for tax law changes to allow employers to tap excess pension benefits to fund retiree health-care costs, resulting in lower pension payments to retirees. One survey of 1,500 employers found that 12% of the firms increased retiree premiums, and about 6% required retirees to contribute more for their health-care benefits.

Employers have received support from the U.S. Supreme Court. In a

1998 decision, the Supreme Court rejected an appeal to a lower court decision affecting 84,000 General Motors (GM) workers. The GM workers claimed that GM had promised free lifetime health-care coverage. However, in supporting the appeals court decision, the Supreme Court ruled that GM had reserved the right to change its benefits plan in some of its plan documents, despite some oral and written promises that retirees would be provided lifetime benefits.

Despite the legal ruling, there is still a troubling ethical issue that a growing number of employers will be facing. That issue is whether to cut benefits to individuals who loyally worked for many years and live for a number of years in the future.<sup>8</sup>

benefits, the Financial Accounting Standards Board (FASB) issued Rule 106 requiring that firms establish accounting reserves for funding retiree health-care benefits. FASB Rule 106 affected many firms, which now must reflect the liability on financial statements and reduce their current earnings each year to fund retiree health-care benefits. Huge write-offs against earnings have been taken by many firms in order to comply with FASB 106.

Another way employers have responded to FASB 106 is to change or discontinue some retiree benefits.<sup>9</sup> The HR Perspective discusses ethical and legal issues associated with this practice.

## Social Security

The Social Security Act of 1935, with its later amendments, established a system providing *old age, survivor's, disability, and retirement benefits*. Administered by the federal government through the Social Security Administration, this program provides benefits to previously employed individuals. Employees and employers share in the cost of Social Security through a tax on employees' wages or salaries.

**SOCIAL SECURITY CHANGES** Since the system's inception, Social Security payroll taxes have risen to 15.3% currently, with employees and employers each paying 7.65% up to an established maximum.<sup>10</sup> In addition, Medicare taxes have more than doubled, to 2.9%. But benefits also became increasingly generous during the 1960s and 1970s. When generous benefits collided with a steep drop in labor-force growth, which slowed the growth of the amount being paid in to the system, problems emerged. Several other factors have created additional pressures: Social Security payments were tied to the cost of living (through the Consumer Price Index), which brought about automatic increases in payments. Increasing numbers of persons are covered by the Social Security system. Further, the aging of the U.S. population—and more people living longer—places increasingly severe strains on the system for the future as more and more people become eligible for payments. All of these problems have raised concerns about the availability of future funds from which to pay benefits.<sup>11</sup> The political cartoon captures these concerns.

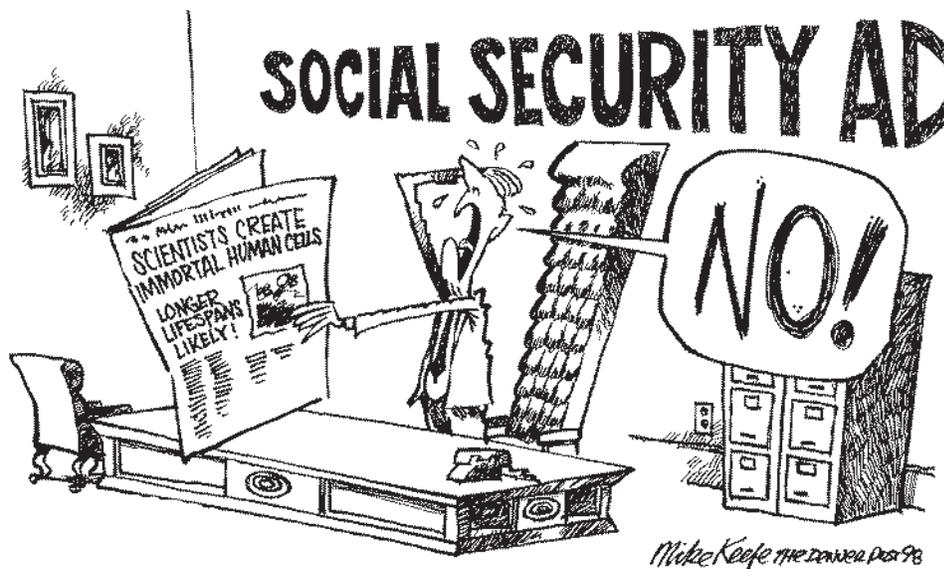
Because the Social Security system affects a large number of individuals and is government operated, it is a politically sensitive program. Congress has in part been responding to popular pressure when it has raised payments *and* introduced cost-of-living adjustments. At the same time, Congress must respond to criticism that the system is in trouble. Yet critics believe that further changes will be needed to ensure the future viability of the Social Security system.

## Pension Plans

**Pension plans** are retirement benefits established and funded by employers and employees. Organizations are not required to offer pension plans to employees, and only 40% to 50% of U.S. workers are covered by them. Smaller firms offer them less often than large ones. Many employers do not offer pension plans

### Pension plans

Retirement benefits established and funded by employers and employees.





**BNA: 2640.10–  
2640.20**

### **ERISA Benefit Plan Requirements**

This section contains an overview of the primary provisions of ERISA as they affect employee benefit plans, specifically pension and welfare plans.

#### **Contributory plan**

Pension plan in which the money for pension benefits is paid in by both employees and employers.

#### **Noncontributory plan**

Pension plan in which all the funds for pension benefits are provided by the employer.

#### **Defined-contribution plan**

Pension plan in which the employer makes an annual payment to an employee's pension account.

#### **Defined-benefit plan**

Pension plan in which an employee is promised a pension amount based on age and service.

#### **Vesting**

The right of employees to receive benefits from their pension plans.

primarily because of the costs and administrative burdens imposed by government legislation, such as the law discussed next.

**EMPLOYEE RETIREMENT INCOME SECURITY ACT (ERISA)** It was widespread criticism of many pension plans that led to the passage of the Employee Retirement Income Security Act (ERISA) in 1974. The purpose of this law is to regulate private pension plans in order to assure that employees who put money into them or depend on a pension for retirement funds actually will receive the money when they retire.

ERISA essentially requires many companies to offer retirement plans to all employees if they are offered to any employees. Accrued benefits must be given to employees when they retire or leave. The act also sets minimum funding requirements. Plans that do not meet these requirements are subject to IRS financial penalties. Employers are required to pay plan termination insurance to ensure that employee pensions will be there even if the company goes out of business.

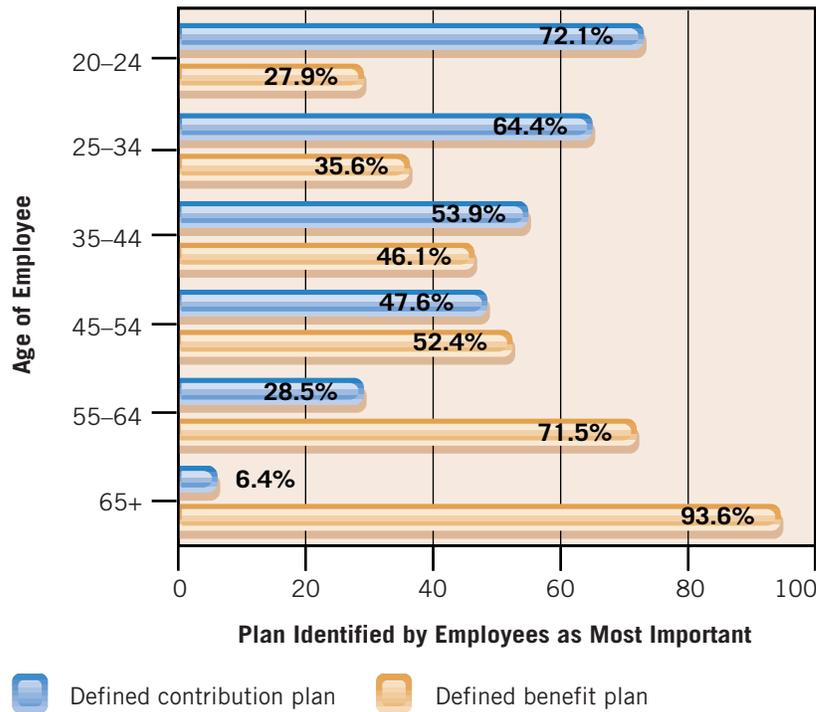
**PENSION CONTRIBUTIONS** Pension plans can be either contributory or noncontributory. In a **contributory plan**, money for pension benefits is paid in by both the employee and the employer. In a **noncontributory plan**, the employer provides all the funds. As would be expected, the noncontributory plan is preferred by employees and labor unions.

**PENSION BENEFITS** Payment of benefits can follow one of two plans. In a **defined-contribution plan**, the employer makes an annual payment to an employee's pension account. The key to this plan is the *contribution rate*; employee retirement benefits depend on fixed contributions and employee earnings levels. Profit-sharing plans, employee stock ownership plans (ESOPs), and thrift plans often are defined-contribution plans. Because these plans hinge on the investment returns on the previous contributions, which can vary according to profitability or other factors, employees' retirement benefits are somewhat less secure and predictable. But because of their structure, these plans are preferred by younger, shorter-service employees, as shown in Figure 15–5.

In a **defined-benefit plan**, an employee is promised a pension amount based on age and service. The employers' contributions are based on actuarial calculations that focus on the *benefits* to be received by employees after retirement and the *methods* used to determine such benefits. The amount of an individual employee's benefits is determined by the person's length of service with the organization and the person's average earnings over a five-year or longer period. A defined-benefit plan gives the employee greater assurance of benefits and greater predictability in the amount of benefits that will be available for retirement. As Figure 15–5 shows, defined-benefit plans are often more preferred by older workers.<sup>12</sup>

If the funding in a defined-benefit plan is insufficient, the employers may have to make up the shortfall. Therefore, a growing number of employers are dropping defined-benefit plans in favor of defined-contribution plans so that their contribution liabilities are known.<sup>13</sup>

**VESTING RIGHTS** Certain rights are attached to employee pension plans. The right of employees to receive benefits from their pension plans is called **vesting**. Typically, vesting assures employees of a certain pension, provided they have worked a minimum number of years. If employees resign or are terminated before

**FIGURE 15-5 Employee Preference for Retirement Plan Type**

SOURCE: R. Evan Ingle, "Defined Benefit Plans Still Measure Up," *HR Magazine*, June 1997, 127. Reprinted with permission of *HR Magazine* published by the Society for Human Resource Management, Alexandria, VA.

they are vested (that is, before they have been employed for the required time), no pension rights accrue to them except the funds that they have contributed. If employees stay the allotted time, they retain their pension rights and receive benefits from the funds contributed by both the employer and themselves.

**PORTABILITY** Another feature of some employee pensions is **portability**. In a portable plan, employees can move their pension benefits from one employer to another. A commonly used portable pension system in colleges and universities is the Teacher Insurance Annuity Association (TIAA) system. Under this system, any faculty or staff member who accumulates pension benefits at one university can transfer these benefits to another university within the TIAA system. If they leave before retirement, individuals who are not in a portable system must take a *lump-sum settlement* made up of the money that they contributed to the plan plus accumulated interest on their contributions.

A growing number of firms are switching to portable pension plans. Instead of a traditional pension plan in which workers must wait until they retire to receive their pension benefits, the portable plan takes a different approach. Once workers have vested in a plan for a period of time, such as five years, they can transfer their fund balances to other retirement plans if they change jobs. Over 400 firms, including Bell Atlantic, Xerox, and Cigna, have switched to portable plans in the past few years.<sup>14</sup>

### Portability

A pension plan feature that allows employees to move their pension benefits from one employer to another.

**GENDER DISCRIMINATION IN PENSION PLANS** The pension area is like many others in HR management—it is constantly changing. Some relatively recent changes are concerned with making pension plans nondiscriminatory. Here, the term *nondiscriminatory* refers to discrimination against women.

Statistics have shown that women generally live longer than men. As a result, before 1983, women received lower benefits than men for the same contributions. However, this kind of discrimination was declared illegal by a U.S. Supreme Court decision. The *Arizona Governing Committee v. Norris* ruling forced pension plan administrators to use “unisex” mortality tables that do not reflect the gender differential in mortality.<sup>15</sup> To bring legislation in line with this decision, the Retirement Equity Act was passed in 1984 as an amendment to ERISA and the Internal Revenue Code. It liberalized pension regulations that affect women, guaranteed access to benefits, prohibited pension-related penalties owing to absences from work such as maternity leave, and lowered the vesting age.

## Individual Retirement Benefit Options

The availability of several retirement benefit options makes the pension area more complex. The most prominent options are individual retirement accounts (IRAs), 401(k) and 403(b) plans, and Keogh plans. These may be available *in addition* to pension plans.

### Individual retirement account (IRA)

A special account in which an employee can set aside funds that will not be taxed until the employee retires.

**INDIVIDUAL RETIREMENT ACCOUNTS (IRAs)** An **individual retirement account (IRA)** is a special account in which an employee can set aside funds that will not be taxed until the employee retires. The major advantages of an IRA are the ability to accumulate extra retirement funds and the shifting of taxable income to later years, when total income—and therefore taxable income—is likely to be lower. Until 1987, many workers took advantage of IRAs offered by financial institutions, insurance companies, and brokerage firms. However, with the passage of the Tax Reform Act of 1986, IRA use became more limited. Due to federal law changes in 1997, a special type of IRA, called the Roth IRA, was authorized, which likely will make the usage of IRAs grow.

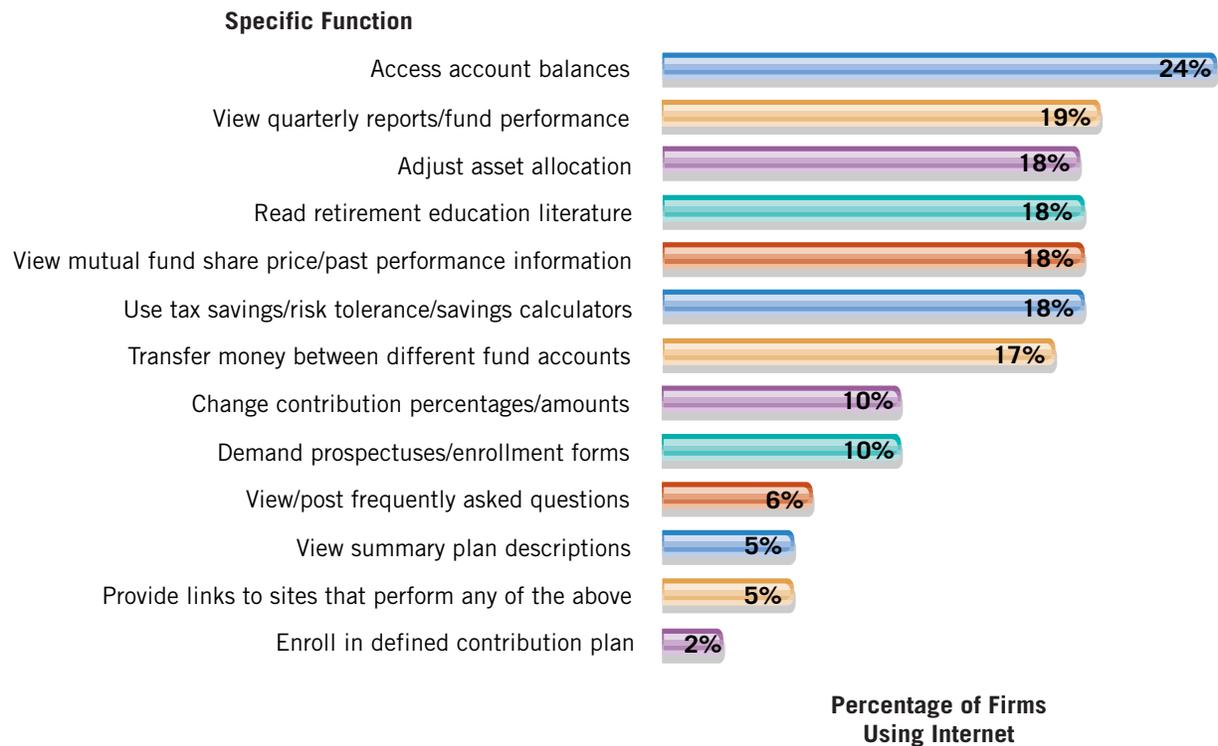
**401(K) AND 403(B) PLANS** Both the 401(k) and 403(b) plans allow employees to elect to have their current pay reduced by a certain percentage and have that amount paid into a retirement plan. The 403(b) plan is available to nonprofit employers, while 401(k) plans are available to the greatest number of employers, particularly those in the private sector. Therefore, for discussion purposes, the focus will be on 401(k) plans due to their greater prominence.

### 401(k) plan

An agreement in which a percentage of an employee's pay is withheld and invested in a tax-deferred account.

The **401(k) plan** gets its name from Section 401(k) of the federal tax code and is an agreement in which a percentage of an employee's pay is withheld and invested in a tax-deferred account. It allows employees to choose whether to receive cash or have employer contributions from profit-sharing and stock-bonus plans placed into tax-deferred accounts.

The use of 401(k) plans and the assets in them have grown significantly in the past few years.<sup>16</sup> The advantage to employees is that they can save approximately \$10,000 per year (as a ceiling) of pretax income toward their retirement. Typically, employers match employee contributions at a 50% rate up to a certain percentage of employee pay, and often employees can contribute additional funds of their own up to the ceiling set by the Internal Revenue Service.

**FIGURE 15-6 Pension & Retirement Functions on the Internet**

\*Percentage of companies with web technology for 401(k) information.

SOURCE: Adapted from *Managing HR Information System*, October 1998, 9. Based on data from the International Foundation of Employee Benefit Plans.

The growing use of the Internet allows employees in a growing number of organizations to check their 401(k) balances and move funds among various financial options. The use of the web-based services is likely to grow in the next few years. The range of options is shown in Figure 15-6.

**KEOGH PLANS** A **Keogh plan** is a special type of individualized pension plan for self-employed persons. These individuals can set aside a percentage of their incomes in pension accounts. Keogh plans can be either defined-contribution or defined-benefit plans. Because of the complexity of Keogh plans and the special regulations covering them, many self-employed individuals seek advice from tax specialists before establishing one.

### Keogh plan

A type of individualized pension plan for self-employed individuals.

## Health-Care Benefits

Employers provide a variety of health-care and medical benefits, usually through insurance coverage. The most common plans cover medical, dental, prescription-drug, and vision-care expenses for employees and their dependents. Basic health-care insurance to cover both normal and major medical expenses is highly

desired by employees. Dental insurance is also important to many employees. Many dental plans include orthodontic coverage, which is usually very costly. Some employer medical insurance plans also cover psychiatric counseling.

## Health-Care Costs

The costs of health-care insurance have escalated at a rate well in excess of inflation for several decades. However, by the mid-1990s, health-care costs had risen to such levels that employers began concerted efforts to control medical premium increases and other health-care related costs. Several approaches to restraining the growth in health-care costs are being used by employers.

One approach to reducing the cost of health care is that a growing number of employers are not offering health-care benefits. One survey of 500 small businesses with 25 or fewer employees found that only 39% of them offer employee health-care benefits, down from 46% in the previous year.<sup>17</sup> These statistics on very small employers reflect the fact that health-care benefits are costs that many firms are not willing or able to incur.

Despite the prevalence of health-care benefit plans in medium and larger employers, the number of workers who have health-care insurance has dropped in the past decade. One study conducted by the AFL-CIO, the union federation, found that fewer U.S. workers have employer-based health insurance than in 1989. Most of the decline of 8 million workers without insurance was attributed to employers dropping health insurance or requiring employees to pay greater percentages of the premiums, which caused some workers to drop health insurance coverage totally.<sup>18</sup> The number of uninsured workers is projected to be 30 million by the year 2005.<sup>19</sup>

A second approach that employers are using to contain health-care costs is to use managed care plans and other cost-control means. Some of the most prevalent ones are discussed next.

## Managed Care

### Managed care

Approaches that monitor and reduce medical costs using restrictions and market system alternatives.

### Preferred provider organization (PPO)

A health-care provider that contracts with an employer group to provide health-care services to employees at a competitive rate.

### Health maintenance organization (HMO)

Managed care plan that provides services for a fixed period on a prepaid basis.

Several types of programs are used to reduce health-care costs paid by employers. **Managed care** consists of approaches that monitor and reduce medical costs using restrictions and market system alternatives. These managed care plans emphasize primary and preventative care, the use of specific providers who will charge lower prices, restrictions on certain kinds of treatment, and prices negotiated with hospitals and physicians. Managed care programs are saving companies billions of dollars by reducing claims, but often such efforts to reduce costs lead to higher costs for employees and a shift in satisfaction with company-provided health plans.

**PREFERRED PROVIDER ORGANIZATIONS (PPOS)** One type of managed care plan is the **preferred provider organization (PPO)**, a health-care provider that contracts with an employer or an employer group to provide health-care services to employees at a competitive rate. Employees have the freedom to go to other providers if they want to pay the difference in costs. *Point of service* plans are somewhat similar and offer financial incentives to encourage employees to use designated medical providers.

**HEALTH MAINTENANCE ORGANIZATIONS (HMOS)** A **health maintenance organization (HMO)** provides services for a fixed period on a prepaid basis.

## HR PERSPECTIVE

## Backlash against Managed Care

The expansion of managed care has resulted in a significant backlash from employees who have been forced into health-care plans that restrict their choices and provide little flexibility. Instead of traditional fee-for-service plans through health insurance policies, whereby individuals choose their physicians and decide when to go see them, many HMOs require that individuals have a *primary care physician* who must authorize all treatment and referrals to specialists. This “gatekeeper”

role is perceived by many as inflexible, time-consuming, and leading to treatments based on cost control rather than health-care needs.

The following results of a survey published in *US News & World Report* reflect the “image” problem that HMOs have. What is evident is that managed care plans are not viewed by those being treated as positively as traditional fee-for-service plans.

Consequently, federal legislation was discussed in 1999 to place

restrictions on what HMOs can do. Also, appeals procedures were identified for those who disagree with HMO treatment and decisions. The provisions of the “patients’ rights” bill were being discussed in Congress at the time this book was completed. Further, some employers are having to offer employees health-care choices that include additional fee-for-service options at somewhat similar costs, rather than having HMOs as the only or lowest-cost alternative.<sup>20</sup>

## Consumer Attitudes about Health Maintenance Organizations

Attitudes differ by health care participants:	Fee for service	Managed care
Very satisfied with choice of doctor	78%	54%
Concerned that doctors base treatment decisions on whether they think plans will pay	21%	32%
Have problems figuring out medical bills	32%	25%
<b>Americans are more likely to think things have gotten worse in terms of:</b>		
Holding down cost of care to families	65%	58%
Providing health care to everyone	41%	36%

Source: Based on a survey of 3,000 adults, published in *US News & World Report*, March 9, 1998, 48.

The HMO emphasizes prevention as well as correction. An employer contracts with an HMO, which has doctors and medical personnel on its staff, to furnish complete medical care, except for hospitalization. The employer pays a flat rate per enrolled employee or per family. The covered individuals may then go to the HMO for health care as often as they need to. Supplemental policies for hospitalization also are provided.

HMO organizations have experienced a flurry of mergers, alliances, and acquisitions. Critics contend that in some cases, competing HMOs are spending millions of dollars on business matters such as destructive price wars and acquiring other businesses instead of focusing on innovation in health care. Employers in some areas are choosing to negotiate with smaller groups of doctors and hospitals, provide employees with information and vouchers, and let them shop among competing medical groups. But, as the HR Perspective indicates, there has been a backlash against managed care, particularly HMOs.

HMOs and other managed care options have accomplished their purpose—to reduce employer costs. One estimate is that managed care programs saved about \$150 billion in health-care costs in six years, for an average of over \$200 per

employee per year. In California alone, it has been estimated that HMOs saved \$770 per family per year.<sup>21</sup> Therefore, it is likely that managed care programs will continue to be the primary means whereby employers provide health-care benefits to employees.

## Other Health-Care Cost Management Tools

Other means used to contain health-care costs include co-payment, utilization reviews, and wellness/communication programs.

### Co-payment

Employee's payment of a portion of the cost of both insurance premiums and medical care.

**CO-PAYMENT** In the past, many employers offered *first-dollar coverage*. With this type of coverage, all expenses, from the first dollar of health-care costs, were paid by the employee's insurance. Previously, a very small deductible amount was paid by the employee; but many basic coverage plans did not require an employee-paid deductible. Experts say that when first-dollar coverage is included in the basic plan, many employees see a doctor for every slight illness, which results in an escalation of the benefits costs.

As health insurance costs rose, employers shifted some of those costs to employees. The **co-payment** strategy requires employees to pay a portion of the cost of both insurance premiums and medical care. Many employers have raised the deductible per person from \$50 to \$250 or more.

### Utilization review

An audit and review of the services and costs billed by health-care providers.

**UTILIZATION REVIEW** Many employers have found that some of the health care provided by doctors and hospitals is unnecessary, incorrectly billed, or deliberately overcharged. Consequently, both employers and insurance firms are requiring that medical work and charges be audited and reviewed through a **utilization review**. This process may require a second opinion, review of procedures used, and review of charges for procedures done.

**WELLNESS AND COMMUNICATION PROGRAMS** Wellness programs try to encourage employees to have more healthy lifestyles. Included in wellness programs are activities such as smoking cessation classes, diet and nutrition counseling, exercise and physical fitness centers and programs, and health education. Wellness programs are discussed in more detail in Chapter 16.

Employers also are educating employees about health-care costs and how to reduce them. Newsletters, formal classes, and many other approaches are used, all designed to make employees more aware of why health-care costs are increasing and what employees can do to control them.

Finally, some employers are offering financial incentives for improving health habits. These programs reward employees who stop smoking, lose weight, and participate in exercise programs, among other actions.

## Health-Care Legislation

The importance of health-care benefits to employers and employees has led to federal legislation that provides some protection to employees who leave their employers, either voluntarily or involuntarily. The two most important ones, COBRA and HIPAA, are known by the acts in which the provisions are contained.

**COBRA PROVISIONS** Legal requirements in the Consolidated Omnibus Budget Reconciliation Act (COBRA) require that most employers (except churches and

the federal government) with 20 or more employees offer *extended health-care coverage* to the following groups:

- Employees who voluntarily quit, except those terminated for “gross misconduct”
- Widowed or divorced spouses and dependent children of former or current employees
- Retirees and their spouses whose health-care coverage ends

Employers must notify eligible employees and/or their spouses and qualified dependents within 60 days after the employees quit, die, get divorced, or otherwise change their status. The coverage must be offered for 18 to 36 months, depending on the qualifying circumstances. The individual no longer employed by the organization must pay the premiums, but the employer may charge this individual no more than 102% of the premium costs to insure a similarly covered employee.

For most employers the COBRA requirements mean additional paperwork and related costs. For example, firms must not only track the former employees but also notify their qualified dependents. The 2% premium addition generally does not cover all relevant costs; the costs often run several percentage points more. Consequently, management efforts to reduce overall health benefits costs have become even more of a concern to employers.

**HIPAA PROVISIONS** The Health Insurance Portability and Accountability Act (HIPAA) of 1996 allows employees to switch their health insurance plan from one company to another to get the new health coverage, regardless of preexisting health conditions. The legislation also prohibits group insurance plans from dropping coverage from a sick employee and requires them to make individual coverage available to people who leave group plans.

## Financial and Other Benefits

Employers may offer workers a wide range of special benefits—financial benefits, insurance benefits (in addition to health-related insurance), educational benefits, social benefits, and recreational benefits. From the point of view of the employer, such benefits can be useful in attracting and retaining employees. Workers like receiving special benefits, which often are not taxed as income.

### Financial Benefits

Financial benefits include a wide variety of items. A *credit union* provides saving and lending services for employees. *Purchase discounts* allow employees to buy goods or services from their employers at reduced rates. For example, a furniture manufacturer may allow employees to buy furniture at wholesale cost plus 10%, or a bank may allow use of a safe deposit box and free checking to its employees.

Employee *thrift, saving, or stock-investment plans* may be made available. Some employers match a portion of the employee’s contribution. These plans are especially attractive to executive and managerial personnel. To illustrate, in a stock-purchase plan, the corporation provides matching funds equal to the amount invested by the employee to purchase stock in the company. In this way,



**BNA: 2829.10–2829.70**

### COBRA Continuation Requirements

The requirements for employers to continue health-care coverage for former employees and others are described in this section. Notice the sample COBRA Election form at 2829.90.10 and compare it to one available from your employer.



**LOGGING ON . . .**

### HIPAA Information

For a detailed review of the provisions in HIPAA, see the following U.S. government website:

<http://gatekeeper.dol.gov/dol/pwba/public/pubs/q&aguide.htm#hipaa>

employees can benefit from the future growth of the corporation. Also, it is hoped that employees will develop a greater loyalty and interest in the organization and its success.

*Financial planning and counseling* are especially valuable to executives, who may need information on investments, tax shelters, and comprehensive financial counseling because of their higher levels of compensation. These financial planning benefits likely will grow as a greater percentage of workers approach retirement age.

Numerous other financial-related benefits may be offered as well. These include the use of a company car and company expense accounts and assistance in buying or selling a house when an employee is transferred.

## Other Insurance Benefits

In addition to health-related insurance, some employers provide other types of insurance. These benefits offer major advantages for employees because many employers pay some or all of the costs. Even when employers do not pay any of the costs, employees still benefit because of the lower rates available through group programs.

**LIFE INSURANCE** It is common for employers to provide *life insurance* for employees. Life insurance is bought as a group policy, and the employer pays all or some of the premiums, but the level of coverage is usually low and is tied to the employee's base pay. A typical level of coverage is one-and-a-half or two times an employee's annual salary. Some executives may get higher coverage as part of executive compensation packages.

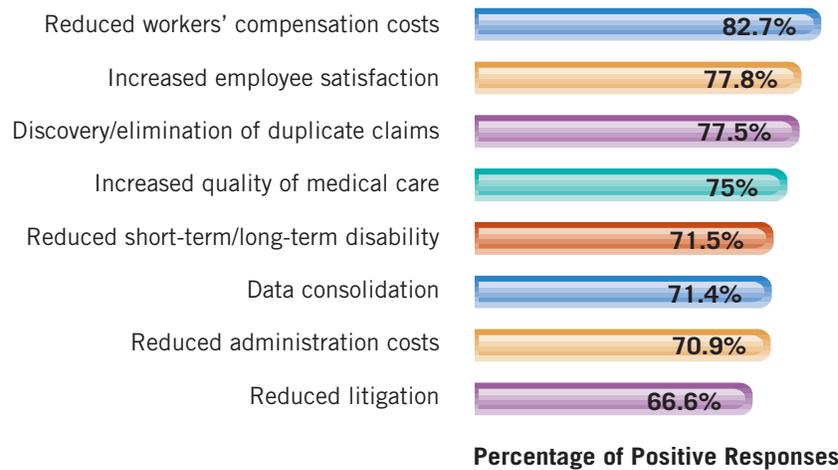
**DISABILITY INSURANCE** Other insurance benefits frequently tied to employee pay levels are *short-term* and *long-term disability insurance*. This type of insurance provides continuing income protection for employees who become disabled and unable to work. Long-term disability insurance is much more common because many employers cover short-term disability situations by allowing employees to accrue the sick leave granted annually.

A growing number of employers are integrating their disability insurance programs with efforts to reduce workers' compensation claims. As Figure 15-7 indicates, there are a number of reasons to have *integrated disability management programs*.

**LEGAL INSURANCE** Legal insurance is offered as a benefit through some employers, often as part of cafeteria benefit plans, which let workers choose from many different benefits. Legal insurance plans operate in much the same way health maintenance organizations do. Employees (or employers) pay a flat fee or a set amount each month. In return, they have the right to use the service of a network of lawyers to handle their legal problems.

## Educational Benefits

Another benefit used by employees comes in the form of *educational assistance* to pay for some or all costs associated with formal education courses and degree programs, including the costs of books and laboratory materials. Some employers pay for schooling on a proportional schedule, depending on the grades received; others simply require a passing grade of C or above.

**FIGURE 15-7 Benefits of Integrated Disability Management\***

\*By percentage of positive responses

SOURCE: Reprinted with permission from *Bulletin to Management (BNA Policy and Practice Series)*, Vol. 49, No. 36, Pp. 285 (Sept. 10, 1998) Copyright 1998 by The Bureau of National Affairs, Inc. (800-372-1033) <<http://www.bna.com>>

Unless the education paid for by the employer meets certain conditions, the cost of educational aid must be counted as taxable income by employees. To qualify as nontaxable income under Section 127 of the Internal Revenue Code, the education must be:

- *Job-related*, in that it is used to maintain or improve a person's skills for the current job
- *Expressly required*, either to meet specific current job requirements or to maintain required professional standing, such as licenses or continuing education
- *Above minimum standards*, meaning that it is not education necessary for the person to qualify for a job initially

Because of U.S. federal budget deficits, repeated attempts have been made to include all educational benefits as taxable income to employees, thereby raising the taxes to be paid by employees using those benefits. Some proposals have attempted to narrow the criteria for deciding if education is job related and expressly required. As of the writing of this text, those efforts have been unsuccessful, and many employer-provided educational benefits remain nontaxable to employees.

## Social and Recreational Benefits

Some benefits and services are social and recreational in nature, such as bowling leagues, picnics, parties, employer-sponsored athletic teams, organizationally owned recreational lodges, and other sponsored activities and interest groups. As interest in employee wellness has increased, more firms have begun to provide recreational facilities and activities. But employers should retain control of all events associated with their organizations because of possible legal responsibility.

The idea behind social and recreational programs is to promote employee happiness and team spirit. Employees *may* appreciate this type of benefit, but

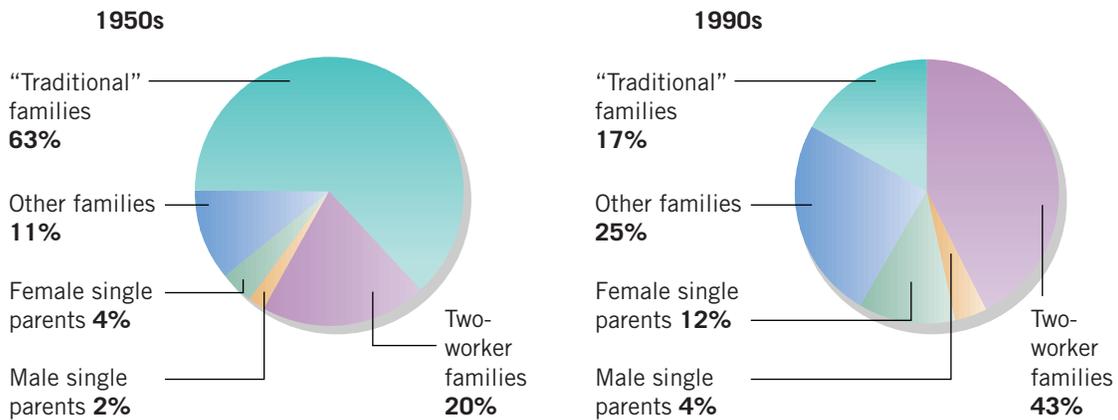
managers should not necessarily expect increased job productivity or job satisfaction as a result. Other such benefits too numerous to detail are made available by various employers as well.

## Family-Oriented Benefits

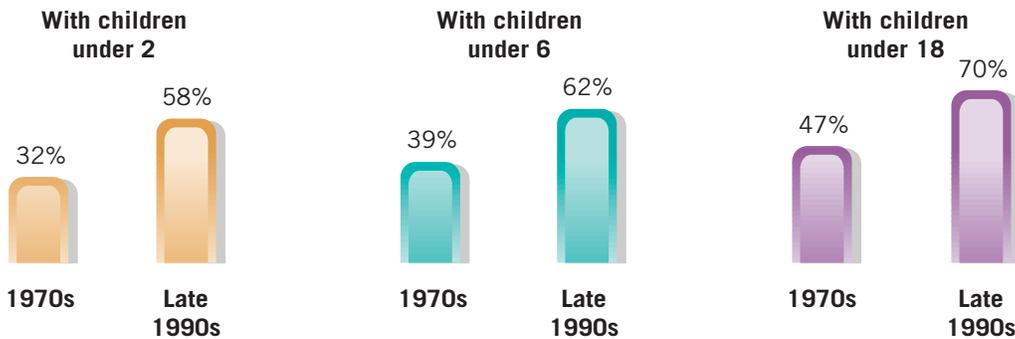
The composition of families in the United States has changed significantly in the past few decades. As Figure 15–8 shows, the number of traditional families, in which the man went to work and the woman stayed home to raise children, has declined significantly, while the percentage of two-worker families has more than doubled.

The growth in dual-career couples, single-parent households, and increasing work demands on many workers has accelerated the emphasis employers are placing on family-oriented benefits. As mentioned in Chapter 1, balancing family and work demands is a major challenge facing many workers at all levels of

FIGURE 15–8 *Changing Composition of Families*



### MOTHERS IN THE WORKFORCE



SOURCE: Bureau of Labor Statistics, U.S. Department of Labor, 1999.

organizations. To provide assistance, employers have established a variety of family-oriented benefits.

## Family and Medical Leave Act (FMLA)

Passed in 1993, the Family and Medical Leave Act (FMLA) covers all employers with 50 or more employees who live within 75 miles of the workplace and includes federal, state, and private employers. Only employees who have worked at least 12 months and 1,250 hours in the previous year are eligible for leaves under FMLA.

**FMLA ELIGIBILITY** The law requires that employers allow eligible employees to take a total of 12 weeks' leave during any 12-month period for one or more of the following situations:

- Birth, adoption, or foster-care placement of a child
- Caring for a spouse, child, or parent with a serious health condition
- Serious health condition of the employee

A **serious health condition** is one requiring inpatient, hospital, hospice, or residential medical care or continuing physician care. An employer may require an employee to provide a certificate from a doctor verifying such an illness.

Regarding taking leaves, FMLA provides for the following:

- Employees taking family and medical leave must be able to return to the same job or a job of equivalent status or pay.
- Health benefits must be continued during the leave at the same level and conditions. If, for a reason other than serious health problems, the employee does not return to work, the employer may collect the employer-paid portion of the premiums from the nonreturning employee.
- The leave taken may be intermittent rather than in one block, subject to employee and employer agreements, when birth, adoption, or foster-child care is the cause. For serious health conditions, employer approval is not necessary.
- Employees can be required to use all paid-up vacation and personal leave before taking unpaid leave.
- Employees are required to give 30-day notice, where practical.

**EMPLOYER REACTIONS TO FMLA** Since the passage of the act, several factors have become apparent. First, many employers have not paid enough attention to the law. Some employers are denying leaves or failing to reinstate workers after leaves are completed.<sup>22</sup> Other employers are retaliating against employees by assigning them more difficult workloads or work schedules.

Employers have had problems with the FMLA. Because of the many different circumstances in which employees may request and use family leave, many employers have difficulty interpreting when and how the provisions are to be applied. Also, the need to arrange work coverage for employees on FMLA leaves can be particularly challenging for smaller employers. This difficulty is compounded because the law requires that workers on these leaves be offered similar jobs at similar levels of pay when they return to work.

## Family-Care Benefits

The growing emphasis on family issues is important in many organizations for many workers. But as the HR Perspective indicates, those employees without

### Serious health condition

A health condition requiring inpatient, hospital, hospice, or residential medical care or continuing physician care.



**BNA: 625.20**

### Family and Medical Leave Act

A copy of the required poster on FMLA that must be posted by employers and details on the provisions of the FMLA can be reviewed here.

## HR PERSPECTIVE

## Benefit “Discrimination” against Childless Workers

With the growing number of employers responding to the family issues faced by workers who have children, one group of employees increasingly is feeling left out: those without children. As more employers stress being family-friendly, to those workers without children at home that increasingly seems to mean being “friendly” only to those workers with children at home.

Silent resentment is growing among the two-thirds of all workers who *do not* have children under age 18. These workers have less opportunity to use certain benefits programs. For instance, employees

without children use significantly fewer of such benefits as telecommuting, floating holidays, and personal days off. Some “childless” employees have been told by their bosses that they must be the ones to travel or put in extra hours, so that employees with families can spend more time with their children. Many childless employees feel that they are “subsidizing” those workers with children through more intense work schedules, heavier travel demands, and using fewer benefits.

Whether this resentment is voiced or stays hidden, there is enough of it that some employers

are having to change some benefits to allow childless workers to use more flexible schedules and allow salaried employees to take additional time off. Of course, if that does not work, one childless worker suggests putting a picture of a small child on his desk and pretending to take off when he wants to in order to care for his “child.” Obviously, this particular example raises ethical concerns, but the broader ethical and morale issues of benefits “discrimination” against childless workers will grow in the future, at least until childless workers face elder-care problems.<sup>23</sup>

families are feeling some resentment against those who seem to get special privileges because they have families.

**ADOPTION BENEFITS** Many employers have had maternity and paternity benefits for employees who give birth to children. In the interest of fairness, a growing number of organizations provide benefits for employees who adopt children. In comparison to those giving birth, a relatively small number of employees adopt children, but there is a fairness issue that employers have addressed by providing adoption benefits. For example, Microsoft gives a \$5,000 cash benefit and four weeks of paid leave to employees who adopt children. Wendy’s provides \$4,000 cash payments to cover adoption expenses and up to six weeks of paid leave for employee adoptions.<sup>24</sup>

**CHILD CARE** Balancing work and family responsibilities is a major challenge for many workers. Whether single parents or dual-career couples, these employees often experience difficulty in obtaining high-quality, affordable child care.

Employers are addressing the child-care issue in several ways. Some organizations provide on-site day-care facilities. Relatively few such facilities have been established, primarily because of costs and concerns about liability and attracting sufficient employee use. However for a number of firms, providing on-site child care has had a positive impact on employees who use the service.<sup>25</sup> Having on-site child care also has been an advantage in recruiting workers in tight labor markets.

Other options for child-care assistance include:

- Providing referral services to aid parents in locating child-care providers
- Establishing discounts at day-care centers, which may be subsidized by the employer

**LOGGING ON . . .****Work & Family Connection**

This website describes companies that subsidize emergency child care and elder care for their employees. The program is run by the Visiting Nurses Association, and provides care for mildly ill dependents with as little as 2 hours notice.

<http://www.workfamily.com/emergency.htm>

- Arranging with hospitals to offer sick-child programs partially paid for by the employer
- Developing after-school programs for older school-age children, often in conjunction with local public and private school systems

**ELDER CARE** Another family-related issue of growing importance is caring for elderly relatives. Various organizations have surveyed their employees and found that as many as 30% of them have had to miss work to care for an aging relative. The responsibilities associated with caring for elderly family members have resulted in reduced work performance, increased absenteeism, and more personal stress for the affected employees.

One study estimated that lost productivity and absenteeism by workers caring for elders costs employers at least \$29 billion per year.<sup>26</sup> Some responses by employers have included conducting needs surveys, providing resources, and giving referrals to elder-care providers. Some employers provide eldercare assistance through contracts with firms that arrange for elder care for employee's relatives located in other geographic locales.

## Benefits for Domestic Partners and Spousal Equivalents

As lifestyles have changed in the United States, employers are being confronted with requests for benefits by employees who are not married but have close personal relationships with others. The employees who are submitting these requests are:

- Gay and lesbian employees requesting benefits for their partners
- Unmarried employees who have living arrangements with individuals of the opposite sex

The terminology most often used to refer to individuals with such living arrangements are *domestic partners* and *spousal equivalents*.

The argument made by these employees is that if an employer provides benefits for the spouses of married employees, then benefits should be provided for employees with alternative lifestyles and relationships as well. This view is reinforced by: (1) the fact that more gays and lesbians are being open about their lifestyles; and (2) data showing that a significant percentage of heterosexual couples live together before or instead of formally marrying.

Some cities, such as San Francisco, have passed laws requiring employers with city contracts to provide domestic partner benefits. The State of Hawaii also has such a law.

Some employers have voluntarily offered benefits to eligible domestic partners. These firms include Lotus Development Corporation, Walt Disney, Levi Strauss & Company, U.S. West, Coors Brewing, and Ben & Jerry's Homemade, Inc. At Lotus, both the employee and the "eligible partner" must sign an "Affidavit of Spousal Equivalence." In this affidavit, the employee and the partner are asked to affirm that:

- Each is the other's only spousal equivalent.
- They are of the same sex and/or not blood relatives.
- They are living together and jointly share responsibility for their common welfare and financial obligations.

Disney's decision to extend benefits to domestic partners has come under attack from certain religious leaders opposed to homosexual lifestyles. However,

one interesting facet is that for a number of employers, most of those using the domestic partner benefits are of the opposite sex and are involved in heterosexual relationships.

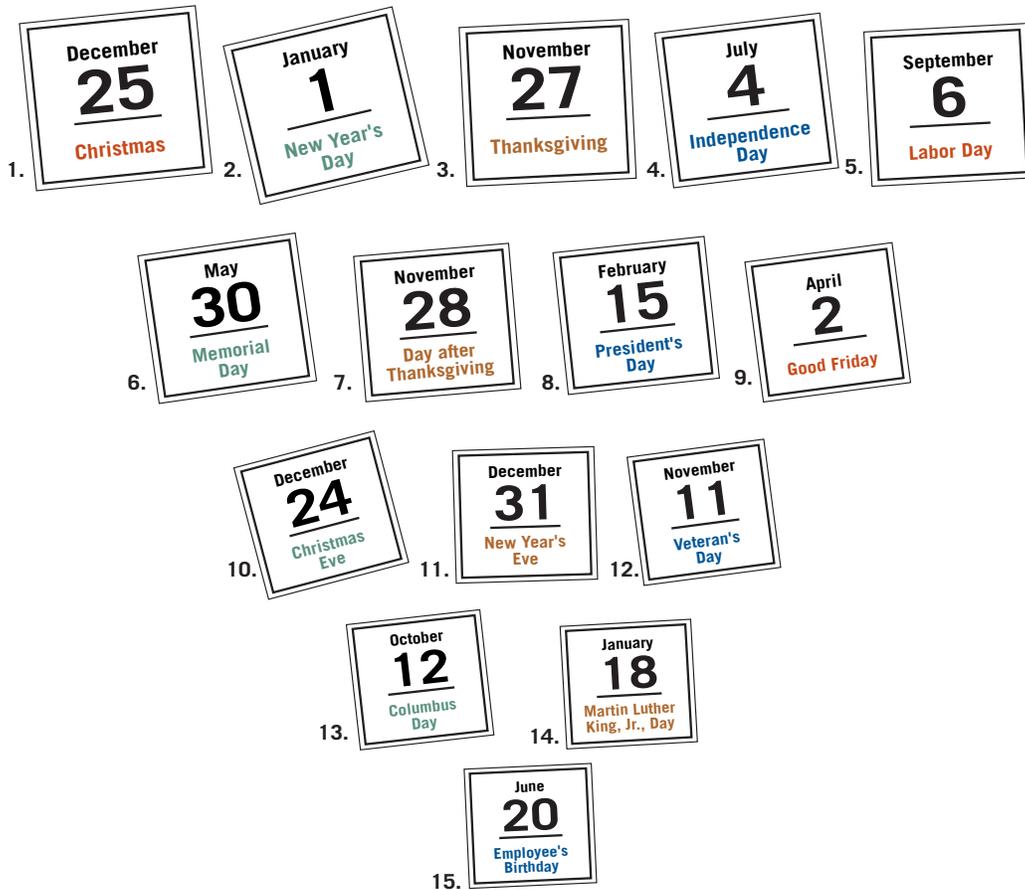
## Time-Off Benefits

Employers give employees paid time off in a variety of circumstances. Paid lunch breaks and rest periods, holidays, and vacations are the most well known. But leaves are given for a number of other purposes as well. Time-off benefits are estimated to represent from about 5% to 13% of total compensation. Some of the more common time-off benefits include holiday pay, vacation pay, and leaves of absence.

### Holiday Pay

Most, if not all, employers provide pay for a variety of holidays, as Figure 15–9 shows. Other holidays are offered to some employees through laws or union con-

FIGURE 15–9 *Most Common Paid Holidays in the United States*



tracts. As an abuse-control measure, employers commonly require employees to work the last scheduled day before a holiday and the first scheduled workday after a holiday to be eligible for holiday pay. Some employers pay time-and-a-half to hourly employees who must work holidays.

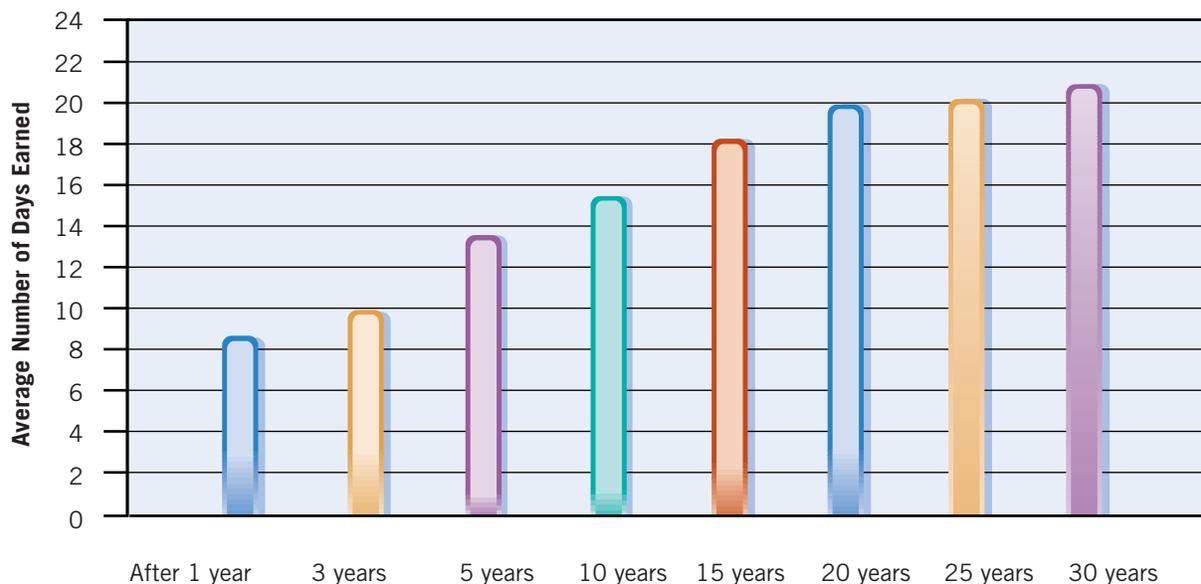
## Vacation Pay

Paid vacations are a common benefit. Employers often use graduated vacation-time scales based on employees' length of service. Some organizations allow employees to accumulate unused vacation. A growing number of companies are allowing employees to "buy" additional vacation or let them sell unused vacation back to employers. About 25% of all surveyed firms permit such options.<sup>27</sup> As with holidays, employees often are required to work the day before and the day after a vacation. Figure 15–10 shows the average number of paid vacation days earned in the United States.

## Leaves of Absence

*Leaves of absence*, taken as time off with or without pay, are given for a variety of reasons. All of the leaves discussed here add to employer costs even when they are unpaid, because usually the missing employee's work must be covered, either by other employees working overtime or by temporary employees working under contract.

**FIGURE 15–10** *Average Paid Vacation Days Earned in the United States*



SOURCE: Data from U.S. Department of Labor, U.S. Bureau of Labor Statistics.

**Well-pay**

Extra pay for not taking sick leave.

**Earned-time plan**

Plan that combines all time-off benefits into a total number of hours or days that employees can take off with pay.

**FAMILY LEAVE** As mentioned earlier in the chapter, the passage of the Family and Medical Leave Act (FMLA) helped clarify the rights of employees and the responsibilities of most employers. Even though *paternity leave* for male workers is available under FMLA, a relatively low percentage of men take it. The primary reason for the low usage is a perception that it is not as socially acceptable for men to stay home for child-related reasons. That view likely will change as a result of the increase in dual-career couples in the workforce.<sup>28</sup>

**MEDICAL AND SICK LEAVE** Medical and sick leave are closely related. Many employers allow their employees to miss a limited number of days because of illness without losing pay. Some employers allow employees to accumulate unused sick leave, which may be used in case of catastrophic illnesses. Others pay employees for unused sick leave.

Some organizations have shifted emphasis to reward people who do not use sick leave by giving them **well-pay**—extra pay for not taking sick leave. Other employers have made use of the **earned-time plan**, which combines sick leave, vacations, and holidays into a total number of hours or days that employees can take off with pay. One organization found that when it stopped designating a specific number of sick-leave days and an earned-time plan was implemented, absenteeism dropped, time off was scheduled better, and employee acceptance of the leave policy improved.

**PAID TIME-OFF (PTO) PLANS** Still other firms are using *paid-time off plans*, which lump various time-off-with-pay days together in one package to be used at the employee's discretion. The new programs provide more flexibility in using time off, and some say they add dignity to the process of taking time off. Employers note that they save administrative costs as well.<sup>29</sup>

**OTHER LEAVES** Other types of leaves are given for a variety of purposes. Some, such as *military leave*, *election leave*, and *jury leave*, are required by various state and federal laws. Employers commonly pay the difference between the employee's regular pay and the military, election, or jury pay. Some firms grant employees military time off and give them regular pay while the employees also receive military pay. Federal law prohibits taking discriminatory action against military reservists by requiring them to take vacation time to attend summer camp or other training sessions. However, the leave request must be reasonable and truly required by the military.

*Funeral or bereavement leave* is another common leave offered. Leave of up to three days for immediate family members is usually given, as specified in many employers' policy manuals and employee handbooks. Some policies also give unpaid time off for the death of more distant relatives or friends.

## Benefits Administration

With the myriad of benefits and regulations, it is easy to see why many organizations must make coordinated efforts to administer benefits programs. Figure 15–11 shows how benefits administration responsibilities can be split between HR specialists and other managers. The greatest role is played by HR specialists, but managers are responsible for some of the communication aspects of benefits administration.

**FIGURE 15–11 Typical Benefits Administration Responsibilities**

HR Unit	Managers
<ul style="list-style-type: none"> <li>• Develops and administers benefit systems</li> <li>• Answers employees' technical questions on benefits</li> <li>• Assists employees in filing benefit claims</li> <li>• Coordinates special preretirement programs</li> </ul>	<ul style="list-style-type: none"> <li>• Answer simple questions on benefits</li> <li>• Maintain liaison with HR specialists on benefits</li> <li>• Maintain good communications with employees near retirement</li> </ul>

## Benefits Communication

Employees generally do not know much about the values and costs associated with the benefits they receive from employers. Yet benefits communication and benefits satisfaction are linked. Many employers have instituted special benefits communication systems to inform employees about the value of the benefits they provide.<sup>30</sup>

**BENEFITS STATEMENTS** Employers also give each employee an annual “personal statement of benefits” that translates benefits into dollar amounts. Federal regulations under ERISA require that employees receive an annual pension-reporting statement, which also can be included in the personal statements. By having a personalized statement, each employee can see how much his or her own benefits are worth. Employers hope that by educating employees on benefit costs, they can manage expenditures better and can give employees a better appreciation for the employers' payments.

**HRIS AND BENEFITS COMMUNICATION** The advent of HRIS options linked to intranets provides additional links to communicate benefits to employees. The use of employee self-service kiosks, as mentioned in Chapter 2, allows employees to obtain benefits information on-line. These kiosks and other information technology also allow employees to change their benefits choices, track their benefits balances, and submit questions to HR staff members and external benefits providers. HR professionals are utilizing information systems to communicate benefits information, conduct employee benefit surveys, and provide other benefits communications.

## Flexible Benefits

A **flexible benefits plan**, sometimes called a *flex* or *cafeteria* plan, allows employees to select the benefits they prefer from groups of benefits established by the employer. By making a variety of “dishes,” or benefits, available, the organization allows each employee to select an individual combination of benefits within some overall limits. As a result of the changing composition of the workforce, flexible benefits plans have grown in popularity.

### Flexible benefits plan

One that allows employees to select the benefits they prefer from groups of benefits established by the employer.

As Figure 15–12 indicates, flexible benefits plans are used more by larger employers than by smaller ones. Primarily because benefits vendors require a sufficient number of employees to make providing the choices worthwhile, generally it has been recommended that at least 100 employees are needed before a flexible benefits plan is considered feasible.

These flexible benefits systems recognize that individual employee situations differ because of age, family status, and lifestyles. For instance, individuals in dual-career couples may not want the same benefits from two different employers. Under a flex plan, one of them can forgo some benefits available in the partner's plan and take other benefits instead.

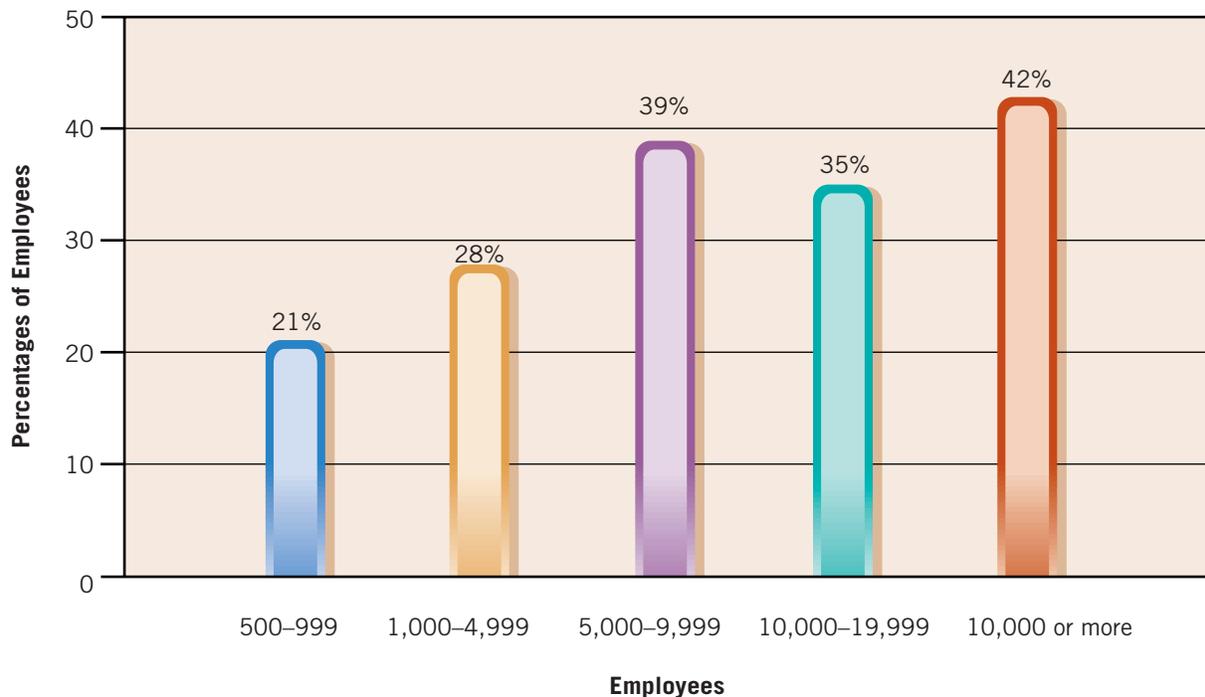
### Flexible spending account

Account that allows employees to contribute pretax dollars to buy additional benefits.

**FLEXIBLE SPENDING ACCOUNTS** Under current tax laws (Section 125 of the Tax Code administered by the Internal Revenue Service), employees can divert some income before taxes into accounts to fund certain benefits. These **flexible spending accounts** allow employees to contribute pretax dollars to buy additional benefits. An example illustrates the advantage of these accounts to employees. Assume an employee earns \$3,000 per month and has \$100 per month deducted to put into a flexible spending account. That \$100 does not count as gross income for tax purposes, so her taxable income is reduced. The employee uses the money in the account to purchase additional benefits.

Under tax law at the time of this writing, the funds in the account can be used only to purchase the following: (1) *additional health care* (including offsetting de-

**FIGURE 15–12 Flexible Benefits Plans by Employer Size**



SOURCE: Based on data from KPMG Peat Marwick, as appearing in *1998 Benefits Sourcebook, Employee Benefits News*, 24. Used with permission.

ductibles), (2) *life insurance*, (3) *disability insurance*, and (4) *dependent-care benefits*. Furthermore, tax regulations require that if employees do not spend all of the money in their accounts by the end of the year, they forfeit it. Therefore, it is important that employees estimate very closely the additional benefits they will use.

Flexible spending accounts have grown in popularity as more flexible benefits plans have been adopted by more employers. Of course, such plans and their tax advantages can be changed as Congress passes future health-care and tax-related legislation.

**ADVANTAGES OF FLEXIBLE BENEFITS PLANS** The flexible benefits approach has several advantages. First, this scheme takes into consideration the complexity of people and situations. Because employees in an organization have different desires and needs, they can *tailor benefit packages* to fit their individual life situations within the limits of legal restrictions.

The second advantage, and certainly an important one to most employers, is that flex plans can aid in *benefits cost-control efforts*. Although employers without flex plans can take cost-containment steps, the decision by employers to reduce benefits or increase co-payments is made easier and is more palatable to employees when these measures are integrated into flex plans.

Another advantage of the flexible benefits approach is heightened *employee awareness* of the cost and value of the benefits. Because they must determine what benefits they will receive, employees know what the trade-offs are.<sup>31</sup>

The fourth advantage is that employers with flexible benefits plans can recruit, hire, and retain employees more easily because of the *attractiveness* of flexible plans. If they can tailor benefits to their needs, employees may not be as interested in shifting to other employers with fixed benefits plans.<sup>32</sup>

**DISADVANTAGES OF FLEXIBLE BENEFITS PLANS** The flexible approach to benefits is not without some drawbacks. The major problem is the *complexity* of keeping track of what each individual chooses, especially if there are a large number of employees. Sophisticated computer software is now available to manage these complexities. Also, the *increase in benefits communications costs* is a concern. As more benefits are made available, employees may be less able to understand the options because the benefits structure and its provisions may become quite complicated.

A third problem is that an *inappropriate benefits package* may be chosen by an employee. A young construction worker may not choose a disability benefit; however, if he or she is injured, the family may suffer financial hardship. Part of this problem can be overcome by requiring employees to select a core set of benefits (life, health, and disability insurance) and then offering options on other benefits.

A final problem can be **adverse selection**, whereby only higher-risk employees select and use certain benefits. Because many insurance plans are based on a group rate, the employer may face higher rates if insufficient numbers of employees select an insurance option.

Despite these disadvantages, it is likely that flex plans will continue to grow in popularity. The ability to match benefits to differing employee needs, while also controlling some costs, is so attractive that employers will try to find ways to overcome the disadvantages while attuning all of their benefits plans to the 21st century.

#### **Adverse selection**

Situation in which only higher-risk employees select and use certain benefits.

## Summary

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- Benefits provide additional compensation to employees as a reward for having organizational membership.
- Because benefits generally are not taxed, they are highly desired by employees. The average employee now receives an amount equal to about 40% of his/her pay in benefit compensation.
- Strategic reasons for offering benefits include attracting and retaining employees, improving the company's image, and enhancing job satisfaction.
- The general types of benefits include security, retirement, health-care, financial, social and recreational, family-oriented, and time-off.
- An important distinction is made between mandated and voluntary benefits. Mandatory benefits are required by law.
- Three prominent security benefits are workers' compensation, unemployment compensation, and severance pay.
- Organizations that provide retirement-related benefits should develop policies on how to integrate Social Security benefits into employees' benefit plans.
- The pension area is a complex one, and it is governed by the Employee Retirement Income Security Act (ERISA) and other laws.
- Individual retirement accounts (IRAs), 401(k) plans, and Keogh plans are important individual options available for supplementing retirement benefits.
- Health-care benefits are the most costly insurance-related benefits. Employers have become more aggressive in managing their health-care costs.
- Various types of insurance, financial planning assistance, tuition aid, and other benefits that employers may offer enhance the appeal of benefits to employees.
- Family-related benefits include complying with the Family and Medical Leave Act (FMLA) of 1993 and offering both child-care and elder-care assistance.
- Holiday pay, vacation pay, and various leaves of absence are means of providing time-off benefits to employees.
- Because of the variety of benefit options available and the costs involved, employers need to develop systems to communicate these options and costs to their employees.
- Flexible benefits systems, which can be tailored to individual needs and situations, have grown in popularity.

## Review and Discussion Questions

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1. Why have benefits grown in strategic importance to employers?
2. Discuss the following statement: "Employers should expect that more benefits will become mandatory and that voluntary benefits will become more varied."
3. Why are workers' compensation, unemployment compensation, and severance pay appropriately classified as security-oriented benefits?
4. Define the following terms: (a) *contributory plan*, (b) *defined-benefit plan*, (c) *portability*, (d) *vesting*.
5. Discuss the following statement: "Health-care costs are out of control in the United States, and it is up to employers to put pressure on the medical system to reduce costs."
6. Some experts have forecasted that family-oriented and time-off benefits will expand in the future. Why?
7. Why are benefits communications and flexible benefits systems so intertwined?

## Terms to Know

401(k) plan 504	health maintenance organization (HMO) 506	preferred provider organization (PPO) 506
adverse selection 521	individual retirement account (IRA) 504	serious health condition 513
benefit 492	Keogh plan 505	severance pay 497
contributory plan 502	managed care 506	utilization review 508
co-payment 508	mandated benefits 494	vesting 502
defined-benefit plan 502	noncontributory plan 502	well-pay 518
defined-contribution plan 502	pension plans 501	workers' compensation 496
earned-time plan 518	portability 503	
flexible benefits plan 519		
flexible spending account 520		

## Using the Internet



### OWBPA and Early Retirement Plans

As the HR manager of your organization, you are in charge of all benefits and compliance with the laws. Senior management is considering offering a voluntary early retirement plan for employees who are age 55 or older and have at least 10 years of service. Before making the final decision to proceed with the early retirement option, the managers have asked you

to investigate and report back about the effects of the Older Workers Benefit Protection Act (OWBPA) and the conditions that must be met. Using the following website from the Employment Law Resource Center, write your report.

**<http://www.ahipubs.com/FAQ/benefits/older.html>**

## CASE

### Don't Cut My Benefits

Organizational mergers and acquisitions have been numerous during the last decade, and the trend shows little evidence of easing. Such combinations often are driven by the attraction of economies of scale and increased market share. The joined companies usually want to combine their benefit plans to reduce administrative costs and to provide the same benefits for all the employees. But often unnoticed in the atmosphere surrounding the merger or takeover are the difficulties and potential costs of merging benefits programs.

The difficulties are seen when Federal Mogul acquired Fel-Pro. Although both firms are auto parts manufacturers, they are very different in corporate culture. Federal Mogul, with 13,000 employees, has numerous unionized workers represented by the

United Auto Workers and United Steel Workers. However, Fel-Pro, with 2,700 employees, had no unionized workers. The difference in culture and employee relations resulted in each firm having significantly different benefit plans.

Fel-Pro, as a family-owned firm based in Chicago, had established a broad range of highly employee-oriented benefits. For example, Fel-Pro had a company-owned summer camp for employees' children and funded college scholarships now worth \$3,500 per child in grants for employees' children. As a result, Fel-Pro had employee loyalty, low employee turnover, and a highly team-oriented environment.

Federal Mogul's culture and benefits program did not include many of the Fel-Pro benefits. Instead, having a union-dominated environment, the benefits

plan for Federal-Mogul employees had been gained through years of union-management negotiation and bargaining. Therefore, its benefits program contained few of the family-friendly and flexible benefits offered by Fel-Pro.

The acquisition of Fel-Pro made strategic sense for Federal Mogul. But executives at Federal Mogul had to confront two worries: (a) that Federal Mogul employees might want to add the Fel-Pro benefits; and (b) that the Fel-Pro employees would react very negatively if some benefits were discontinued, thus affecting productivity and morale.

To address these issues, Richard Snell, chairman of Federal Mogul, had to reassure Fel-Pro employees that the combined companies would continue to provide good benefits. But he stated that the scholarships would continue for five years and might be discon-

tinued after that. Also, it was decided that the summer camp would operate for two more years. But the Fel-Pro employees have recognized that the organizational culture and job security, as special benefits they had, are likely to be diminished as a result of the acquisition. There is real concern that the benefits changes may diminish the success of the acquired firm.<sup>33</sup>

## Questions

1. Why should evaluating benefits programs be a crucial part of any planning for mergers and acquisitions?
2. What could be done to meld the different benefits plans in ways that balance both employer costs and employee morale considerations?

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