Incentive Compensation: Making Strategy Work

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Organizations spend a lot of time developing strategies that, if executed well, should improve their performance. The challenge is to actually make these strategies work, especially in organizations which are under heavy pressure from multiple sources, such as:

- Customers
- Employees
- Suppliers
- Owners
- Board of Directors
- Lenders
- Auditors
- Government
- Need for Growth
- Innovation
- Technology
- Risks

There are many hurdles and roadblocks to overcome in the process of making strategy work. The important issue is to focus on the key competitive, technological and economic conditions that affect strategy, by asking questions such as:

1. Where is the business now?
2. Where do we want to be in five years?
3. How are we going to get there?
4. What are the anticipated technological and competitive trends and conditions in our industry?
5. How can we take advantage of these trends to improve our results?

Compensation, in particular incentive compensation, should reinforce and support the strategy, not undermine it, because incentives tell people what is important. Organizations always seem to be grappling with the right incentives to help facilitate strategy execution. Incentives should not be set before decisions about strategy, short-term objectives, coordination requirements, and organization structure have been made.

To be effective, the organization’s long-term goals need to be translated into short-term objectives that are consistent with the strategy, that can be communicated, that can be measured, and thus can be properly incented. Short-term thinking is not necessarily bad. Short-term operating objectives are vital to strategic performance if they reflect and are integrated with long-term strategic objectives. Strategy execution will suffer if strategic needs are not properly translated into shorter-term metrics and that can be and are communicated throughout the organization.

In most organizations, individuals want to perform well. Most managers, for example, are motivated to seek and attain positive results. They have a high need for achievement and want to know if they have accomplished something of value.

Welcome
to our client newsletter.
We trust you will find the enclosed information to be timely and useful to your business planning.
If you have any questions regarding this content, please contact your local Gallagher representative.

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Updates to the Ontario Retirement Pension Plan: Potential Multi-Provincial Impacts, Updated Definitions and a Delay

By Kat Lacy-Wilson, J.D., L.L.M. Area Assistant Vice President, Canada Compliance Counsel

As we have informed you in prior articles, the Ontario Retirement Pension Plan (ORPP) is legislation from Ontario’s Ministry of Finance to develop a pension replacement program to work alongside the existing Canadian Pension Plan (CPP) and, if applicable, Quebec Pension Plan (QPP). The Ministry’s goal is to have the ORPP operational no later than 2020.

However, the ORPP is a work in progress, which means that additional guidance and information is still being developed. On January 26, 2016, the Ministry provided its most recent guidance through a technical bulletin, which is available here: http://www.fin.gov.on.ca/en/pension/orpp/bulletin-260116.html. This guidance addressed quite a few issues and the information listed below is just a few of the noteworthy details:

- The ORPP may affect both employees who reside within Ontario and employees who may reside in other provinces but are compensated from an Ontario-based employer.
- The ORPP will define pensionable earnings as both cash and non-cash earnings.
- Whether or not an employer’s already offered workplace plan has “comparable” status is determined at the “level of a subset of employee.” This means that it is possible for an employer’s existing plan to have both comparable and non-comparable arrangements. For example, if the employer’s plan provides a different set of benefits to different groups of employees, each group of employees must be examined to determine whether the benefits as offered to a specific group are comparable with the ORPP. If the employer also offers benefits through a multi-employer pension plan, the comparability test will examine the benefits offered under the employer’s collective bargaining agreements or employee agreements.
- ORPP contributions from the employer and the employee will be due for any waiting period that the employee may participate within while waiting to enroll into the employer’s comparable plan.
- Only defined contribution registered pension plans with a mandatory 8% contribution formula, 4% of which must be employer contributions, will be considered comparable.
- Starting January 1, 2020, employers who offer a comparable workplace plan will be able to opt out of the ORPP.

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In turn, they want objectives that are measurable. Without measurement, there can be no useful assessment of the worth or contribution of a job or department to the execution of a chosen strategy. Good objectives also facilitate accountability. Without clear accountability, people can never feel that they really have skin in the game and, as a result, the motivational aspects of incentives become thwarted or destroyed. Good objectives should never be all or nothing, black or white. They should refer instead to the degree of accomplishment along a desired performance continuum.

High achievers respond to incentives. As a result, it’s vital that the incentives support the desired strategy execution behaviors and outcomes. It is absolutely critical that the organization rewards the doers and the high performers, to celebrate success and to reward those who helped achieve it. But organizations also need to reward cooperation. In practice, organizations tend to reward individual performance much more than cooperative achievement, and this can hurt strategy execution.

Finally, when developing and using incentives, it is important not to demotivate people. The wrong incentives turn people off, can seriously injure their motivation, and undermine their desire to support what would otherwise be a winning organization strategy.

To learn more about this topic, contact your Gallagher representative.
• Non-resident workers, except those exempt from tax under a tax treaty, are also included in the ORPP’s definition of employee. Therefore, those non-resident workers who earn at least $3,500 (the minimum threshold) and have taxable income for Ontario and Canadian tax purposes will also have to contribute to the ORPP unless their employer offers a comparable workplace plan.

In early March 2016, the Ministry disclosed that the first wave for contributions to the ORPP is delayed from January 2017 to January 2018 but the employer registration deadline retains its January 1, 2017 deadline. All of the remaining waves will retain their schedule, with the final wave scheduled to complete in 2020. The following provides more details on the waves’ schedule:

**Wave 1** – January 1, 2018: Employers with 500 or more employees without registered workplace pension plans. The employers and their employees will be required to contribute 0.8% of each applicable employee’s annual earnings.

**Wave 2** – January 1, 2018: Employers with 50 to 499 employees without registered workplace pension plans. Both the wave 1 employers and employees and these new employers and their employees will be required to contribute 1.6% of each applicable employee’s annual earnings.

**Wave 3** – January 1, 2019: Employers with fewer than 50 employees without workplace pension plans. Both the prior waves’ employers and employees and this wave’s employers and their employees will be required to contribute 1.9% of each applicable employee’s annual earnings.

**Wave 4** – January 1, 2020: Employers with a workplace pension plan that’s not modified or adjusted to meet the comparability test as well as employees who aren’t members of the workplace’s comparable plan. All employers and employees subject to the ORPP will have to contribute 1.9% of each applicable employee’s annual earnings.

These contribution amounts are subject to a minimum $3,500 earnings threshold and only refer to the earnings up to a $90,000 limit.

The purpose of this delay is to allow the Federal, Provincial and Territorial Ministers more time to discuss potential enhancements to the CPP, which may reduce the impact of the ORPP on employers and employees.

As always, we will continue to monitor this legislation for any changes and provide appropriate updates to assist employers and employees with their potential future obligations. Should you have any questions in the interim, please feel free to contact your Gallagher consultant for additional guidance.

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**Health Spending Accounts Explained**

*By David Guttman, Senior Benefits Analyst, Gallagher Benefit Services, Inc., Canada*

Extended health and dental care benefits are a great way for an employer to offer employees access to benefits that are not paid for by the provincial health care plan. However, when faced with a diverse employee population, creating a health and dental plan that offers every employee access to the services they need can become very costly, very quickly. Thankfully, there is a product that offers choice to employees without placing unsustainable cost increases on employer-sponsored health and dental programs. This product is a Health Spending Account (HSA).

An HSA is a type of private health services plan (PHSP) in which an employer gives each employee a set dollar amount to pay for medical services that aren’t covered by the provincial health plan or to supplement their traditional health and dental plan. Since an HSA is a PHSP, it therefore has similar tax implications as a traditional benefits plan. This means that claims must be eligible for the Canadian Revenue Agency (CRA) approved medical expense tax credits (METC) to be reimbursed. The important difference between an HSA and a traditional benefit plan lies in what is covered.

In a traditional benefits plan, the employer chooses which medical expenses will be covered. In designing a program employers may specify maximums for benefit coverages and coinsurance, expressed in dollars or percentage. In an HSA, however, all medical expenses listed under the METC by
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the CRA\(^1\) are eligible for payment. For example, you have a drug plan with 80% coinsurance and your drug claim cost $100; under this scenario, the employee has to pay $20 out-of-pocket. This amount ($20) can then be claimed under the employee's HSA account and reimbursed. In another example, the employee has no vision care benefits but has an HSA. The employee purchases prescription glasses and has the expense reimbursed through the HSA. In terms of reimbursement, the dollar limit is based on how much money, or how many credits the plan sponsor has allocated to the employees' HSA.

Plan sponsors are faced with rising benefit costs driven by a combination of increased health care costs and utilization. Employers may want to review why they offer benefits, which benefits are important to employees and what benefits are a “nice-to-have.” Adding an HSA may help offset some of the cost-containment measures employers are forced to implement in order to maintain a sustainable benefit program for employees and mitigate some of the benefit take-aways. Overall, when used strategically, an HSA is a great tool for containing costs for the employer while from the employee's perspective, an HSA provides choice and flexibility, although limited by the dollar or credit amount deposited to the HSA by the employer.

An advantage for some employees may be who can make a claim under an HSA. Under a traditional plan, only eligible dependents are covered. Eligible dependents are typically a spouse and dependent children. Under an HSA, anyone who is considered a dependent under the CRA rules may be eligible to claim under the HSA. For example, if you have elderly dependent parents living in your home, they may not be eligible under the traditional plan but they may meet the CRA eligibility criteria under the HSA, if the employer choses this option at implementation with the insurance carrier.

The administration of an HSA is relatively simple. Every year the employer allocates new credits to employees and any unused credits in the prior year may be forfeited. In addition to the “use it or lose it” method, the CRA offers two other options to plan sponsors. They are credit carry forward and expense carry forward. As with any PHSP, there is a responsibility for the claimant to ensure they have verification of all claims they make in the event of an audit. The length of time to maintain these documents can vary, however, the average length is typically around 12 months.

An example of credit carry forward may be an employee who has $500 allocated to his HSA in 2014. However, in 2014 the employee only claims $400 and has $100 remaining in his account. Starting in 2015 another $500 is allocated to his account. As a result, the employee is eligible to claim up to $600 in 2015, which includes the remaining amount of $100 from 2014 carried forward into the subsequent year.

An example of expense carry forward may be an employee with $500 allocated to them in 2014. However, they have $600 of claims in 2014 so they have $100 of unpaid expenses. In 2015 they are allocated another $500. They may claim the $100 from 2014 towards their 2015 allocation.

In the fall of 2015 the CRA updated their position on what is considered a PHSP. Prior to the change, to be considered a PHSP, all claims being paid must be a listed METC item. The CRA's new position is that "all or substantially all of the premiums paid under the plan relate to medical expenses that are eligible for the METC." According the CRA, substantially all means more than 90% of paid premiums must be for claims that are eligible for the METC. It is not clear what the driving force behind this change was, or what implications it may have on the administration of PHSPs.


\(^1\) Canadian Revenue Agency – New position on private health services plans – Questions and answers – [http://www.cra-arc.gc.ca/whatsnew/tax/phsp-rpam-eng.html]
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