Insights for Optimizing Your Employee Benefit Program

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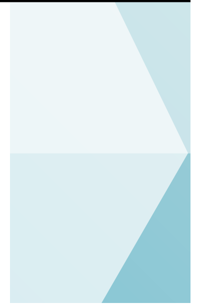

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A Message from Christine Marcks and Andrew Sullivan

A common theme that emerges in conversations with our clients is that cost control and talent management are top of mind. Balancing these goals, especially in today's benefits landscape, requires employers to rethink how they spend their benefits budget to optimize the impact of their benefit offerings. Outcomes that employers wish to optimize against a given benefits budget may include employee satisfaction, productivity, talent attraction and retention, and retirement readiness.

Recognizing that benefit plans may be designed to drive employee behaviors, many employers work with benefits brokers and consultants to optimize benefits using broad frameworks that span group benefits, health and wellness, retirement, and compensation. Prudential offers unique perspectives based on our expertise as a full-service provider of defined contribution, defined benefit, and non-qualified retirement plans, as well as group insurance and voluntary benefits. This expertise, bridging financial protection and retirement security and supported by the increased sophistication of data analytics, is often used by our employer partners to develop customized solutions that optimize not only their individual benefit plans and programs, but also their complete portfolio of benefit offerings. We invite employers and their consultants or advisors to consider these insights, which complement the broader frameworks, as they develop their own benefits optimization strategies.

Christine Marcks
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Introduction

Benefits optimization is an approach to designing a portfolio of employee benefits that maximizes desired workforce outcomes against a given benefits budget. In other words, benefits optimization strategies help employers get the biggest "bang for the buck" in terms of the investment they are making in their benefit programs. How that is defined can vary from employer to employer. Employee satisfaction, productivity, talent attraction and retention, and retirement readiness are just some of the many critical outcomes employers may wish to optimize.

Underpinning the desire to optimize benefits is the consensus among employers as to the importance of employee benefits. Nearly two-thirds (65%) of surveyed finance executives said that employee benefits are critical to attracting and retaining employees, and 63% indicated employee satisfaction with benefits is important for their company's success.[1] Given that, several trends are challenging employers to think more holistically about their benefit offerings and the outcomes they wish to achieve through these offerings. Recent declines in the unemployment rate suggest that the labor market may become more competitive, increasing the importance of compensation and employee benefits. At the same time, healthcare costs continue to increase rapidly,[2] and controlling these costs remains a top priority for employers. The formation of private exchanges has further prompted employers to rethink how they allocate their benefits budget.

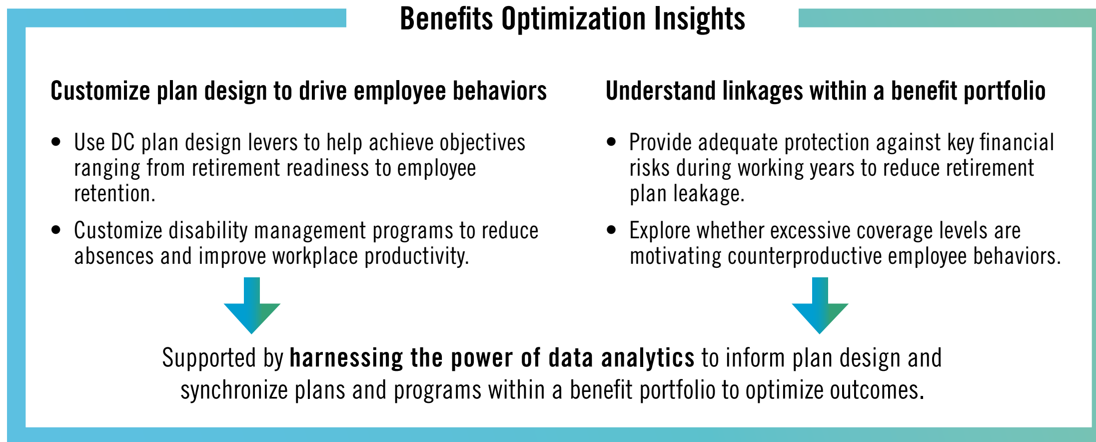
In response, employers are refining their approach to offering employee benefits. Many have broadened their portfolio of benefits, primarily through utilization of voluntary benefits, and added high deductible health plans (HDHPs), both of which shift more of the cost and decision-making responsibilities to employees. This mirrors the shift that has been occurring in retirement plans over the past few decades, whereby employees are bearing more responsibility for their retirement security through defined contribution (DC) plans, while traditional defined benefit (DB) plans have become less common.

Further enabling employers to refine their approach to benefits optimization is the increased availability of data and analytics, which represents a powerful tool that employers can use to learn more about the employee base, gain a better understanding of the types of benefits employees need at various life stages, and predict financial behaviors. These capabilities can be harnessed to design benefit plans, educational programs, and communications materials to drive desired employee behaviors and outcomes.

[1] Prudential and CFO Research Services, *The Value of Employees' Financial Wellness*, February 2016.

[2] Health expenditures are expected to continue to outpace inflation between 2014 and 2024, increasing at an annual rate of 5.8% versus 2.0% for inflation. Sources: Centers for Medicare & Medicaid Services, Office of the Actuary, *National Health Expenditure Projections 2014–2024*; Congressional Budget Office, *Budget and Economic Outlook: Fiscal Years 2015–2025*.

As benefits optimization has emerged as an area of focus for employers, many benefits brokers and consultants have established comprehensive benefits optimization frameworks that span group benefits, health and wellness, retirement, and compensation. Complementing these existing frameworks, Prudential offers unique insights for employers and their consultants or advisors to consider as they develop their own benefits optimization strategies. Specifically, as shown below, this paper focuses on insights related to customizing the design of benefit plans and programs, as well as the importance of understanding linkages between and among the plans and programs within a benefit portfolio, to optimize desired outcomes.



Customize Plan Design to Drive Employee Behaviors

Benefit plans and programs can be designed to help motivate behaviors within specific employee segments and achieve desired outcomes ranging from retirement readiness to worker retention to workplace productivity. Using data analytics to better understand what drives the behaviors of various employee segments may help employers take a more granular and customized approach to plan design, such that employees receive the optimal level of benefits to drive desired behaviors. The section below explores how this thinking can be applied to DC plans as well as to disability management programs.

Use DC plan design levers to help achieve objectives ranging from retirement readiness to employee retention

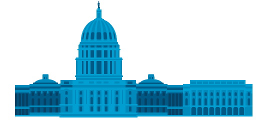
Over the past few decades, DC plans have increasingly become the primary workplace savings vehicle, particularly in the private sector. Unlike traditional DB plans in which investment and longevity risks are borne by the employer, DC plans place the onus on employees to enroll in the plan, save at an appropriate level, invest appropriately, and make savings last through retirement.

DC plans can be designed, however, to make these tasks as easy as possible – even automatic – for employees. For example, employers can optimize the retirement readiness of their employees by incorporating automatic enrollment and automatic contribution escalation, which increases income deferral rates over time. This may help overcome employees' inertia in contributing a meaningful amount to the plan.

Despite these design strategies, many plans with these features set the contribution bar too low for employees to attain a secure retirement. The most common default deferral is 3% of pay, and only 55% of plans with automatic enrollment also include an automatic contribution escalation feature.[3] For the 45% without contribution escalation, this may be interpreted as a tacit signal that a 3% contribution level is adequate for them to attain a secure retirement.

Based on Prudential's research, a model template for 401(k) plans would include:

- Automatic enrollment of employees at a rate of at least 6% of pay, with employees eligible to opt out or select an alternative contribution rate
- Automatic escalation of employee contributions up to at least 10% of pay, in annual 1% increments, also with employee opportunity to opt out



Suggested plan features: at least **6%** automatic enrollment floor with at least **10%** automatic escalation ceiling.

While some employers believe that offering automatic contribution escalation is too costly due to the related impact on employer matching contributions,[4] this hurdle can often be overcome by offering the escalation feature in combination with a design that targets employer contributions to certain employee groups. For example, a DC plan may be designed to optimize matching contributions for employees nearing retirement age who have recently had their DB plans frozen and may be in greater need of a matching contribution as they prepare for retirement. Similarly, employers may utilize matching contributions as a way to attract and retain employees with a specific tenure or sought-after specialty that is in short supply.

Designing plans that allow employers to customize matching contributions to employee segments that may need them – or value them – the most enables employers to get the most for their matching dollars, and may even allow them to implement automatic features without corresponding cost increases. Employer matching contributions, and potentially non-elective and profit-sharing contributions, can vary based on a number of factors, allowing employers with access to powerful analytics capabilities and actuarial expertise to allocate contributions to their employees with "surgical precision" to optimize desired outcomes and to meet important requirements such as discrimination testing.

Longer term, data analytics, combined with actuarial expertise, may provide even more valuable insights about how the plan population will change over time, and may help to inform decisions regarding how to customize the plan design to better achieve desired outcomes among specific employee segments in the future.

[3] Plan Sponsor Council of America, "55th Annual Survey Highlights," http://www.psca.org/55th-annual-survey-highlights
[4] Defined Contribution Institutional Investment Association (DCIIA), *Plan Sponsor Survey 2014*, June 2015.

Customize disability management programs to improve workplace productivity

The direct cost of paid employee absence, estimated to be 8%–15% of an employer's payroll,[5] is significant, and is expected to increase as the multigenerational workforce population ages. As a result, it is important that employers fully understand the cost of absences in their organizations so that they can focus on managing the most costly types of absences. Cost assessments should include both direct (e.g., full or replacement wages) and indirect (e.g., overtime, temporary workers, training) costs, and highlight the cost savings impact of a reduction in the duration of employee absences from the employer's perspective.

To shorten disability leave durations, it is often helpful for employers to establish return-to-work programs that bring employees back to work sooner. Because most employers have little expertise in making workplace accommodations, it is also a good idea to consult with companies that have this expertise to assess any workplace modifications or create transitional return-to-work programs. Hands-on site visits may help identify ways to restructure responsibilities in job families. Critical success factors for positive return-to-work outcomes include:

- **Job design** – develop smarter, less physically taxing ways to accomplish tasks
- **Transitional return-to-work programs** – partner with a physician to develop a plan, and communicate the plan to the employee to take the "guesswork" out of returning to work
- **Workplace flexibility** – provide flexibility, understanding that employees may experience setbacks in their recoveries, whereby they may be able to work one day, but not the next
- **Connection to workplace** – encourage teamwork (a study indicates that a positive relationship with co-workers helps motivate employees to return to work)[6]

Data analytics can also be leveraged to help minimize absence and maximize productivity. For example, employers can employ customized analytics to identify the most frequent types of disability and durations by job title and type of work in their own organizations, or even compare their disability metrics to industry benchmarks. Doing so may lead to identifying data-driven solutions and developing actionable next steps, such as customized disabilities program development.

Employers should use **customized analytics** to identify the most frequent types of disability and durations by **job title and type of work.**

Examples of customized disabilities programs include:

Pharmacist

A drugstore chain that has a high incidence of disabilities among pharmacists may establish programs that target pharmacists. Because pharmacists are highly paid and have significant responsibilities, the chain may consider transitional return-to-work programs to mitigate the impact of their absence.

Nurse

A hospital that needs to retain nursing expertise may find that many nurses are retiring, partially due to the physical nature of the job. The hospital may develop knowledge transfer and mentoring programs that leverage the nurses' expertise, while increasing retention and helping bridge the gap to retirement in a healthy way.

Plant Worker

A manufacturer may support workers' initiatives to self-modify their job responsibilities. For example, older workers may use a cart to carry heavy items, and the employer may leverage this method for younger workers to prevent future disabilities.

[5] The direct cost of paid employee absence is estimated to be 8.1% of payroll, including vacation, personal time, sick time, and other paid time off. Adding in overtime and replacement workers brings the total to 15.4%. Society for Human Resource Management and Kronos, *Total Financial Impact of Employee Absences in the U.S.,* October 2014.

[6] Dr. Kristin Tugman, *The lived experience of being out of work on short term disability: A phenomenological study,* Capella University, ProQuest, UMI Dissertation Publishing, 2013.

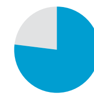
Understand Linkages Within a Benefit Portfolio

While taking a customized approach to designing specific benefit plans may help employers drive employee behaviors, in order to truly optimize their benefit offerings, employers should also evaluate how the individual plans fit together in the benefit portfolio. Since the design of any one benefit plan may have unintended consequences for other plans in a benefit portfolio, it is critical for employers to recognize the interdependencies among various benefit offerings. This section explores the impact that group benefits designed for usage during the working years may have on retirement plans.

Provide adequate protection against key financial risks during working years to reduce retirement plan leakage

An employee's financial behaviors and decisions during working years may affect retirement outcomes. For example, lower levels of financial security during the working years may lessen the likelihood of a secure retirement, potentially leading to financial stress in the workplace and a delayed retirement. Without adequate protection, a disability, critical illness, or accident may precipitate the need for an employee to halt DC plan contributions or even withdraw retirement savings.

This "leakage" from retirement plans during the working years has a significant impact on retirement security. In 2012, employees withdrew $70 billion from their accounts before reaching retirement age – $60 billion of which was subject to tax penalties for early withdrawal.[7] To put this in context, the $70 billion withdrawn equates to 59% of the $118 billion in matching dollars that employers contributed to employees' retirement accounts that same year.[8] Not surprisingly, 77% of surveyed employers that have a loan provision in their plan say they are very or somewhat concerned about loan usage. Sixty-one percent of these employers say they are very or moderately likely to take at least some action to help curtail leakage in 2016.[9]



77% of surveyed employers say they are very or somewhat concerned about **loan usage** within their retirement plans.

About 11% of DC plan withdrawal events are attributable to the onset of poor health,[10] indicating that many employees turn to their retirement accounts to cover out-of-pocket expenses related to a disability or medical event. These early withdrawals can significantly strain retirement savings – a 35-year-old who withdraws $25,000 from a retirement account will forgo over $143,000 in future retirement benefits.[11]

Having adequate disability, critical illness, or accident coverage may help protect employees' future retirement security by reducing their need to withdraw retirement savings. Employers reap benefits from such protection, too. For example, this may help employers protect the investment they have made through their company's match in their employees' retirement readiness. Moreover, employers may want to help their employees maintain adequate protection against key financial risks in the working years, so that employees are more likely to retire on time.

[7] HelloWallet, "The Retirement Breach in Defined Contribution Plans," January 2013.
[8] HelloWallet, "The Retirement Breach in Defined Contribution Plans," January 2013.
[9] Aon Hewitt, "2016 Hot Topics in Retirement and Financial Well-Being," 2016.
[10] Urban Institute Retirement Policy Program, "Understanding Early Withdrawals from Retirement Accounts," 2010.
[11] Assumes 30 years until retirement, 6% annual return. Early Withdrawal Impact Calculator, Smart401k.com, 2015.

Delayed retirements are unfavorable for employers as well as employees. Being unable to retire may cause higher stress levels, a lack of engagement, and lower productivity from older employees who want to retire, and turnover amongst younger employees due to lack of progression. In addition to workforce management implications, delayed retirements have a direct financial cost to employers, due to expected increased compensation, pension/retirement, and benefit costs. In fact, research and analysis regarding the impact of delayed retirements on employers' costs has shown that, using national averages for a simulated workforce, a one-year increase in the average retirement age may result in an incremental 1.0%–1.5% of annual workforce costs.[12] The impact of delayed retirements may vary significantly from one employer to another; data analysis may be used to customize the impact for a specific employer.

Explore whether excessive coverage levels are motivating counterproductive employee behaviors

While inadequate protection during the working years may hurt retirement outcomes, overly generous protection coverage levels may also have unintended adverse consequences. For example, disability insurance is designed to help employees cope with a disability that keeps them out of work temporarily by helping them cover their basic monthly living expenses until they return to work.

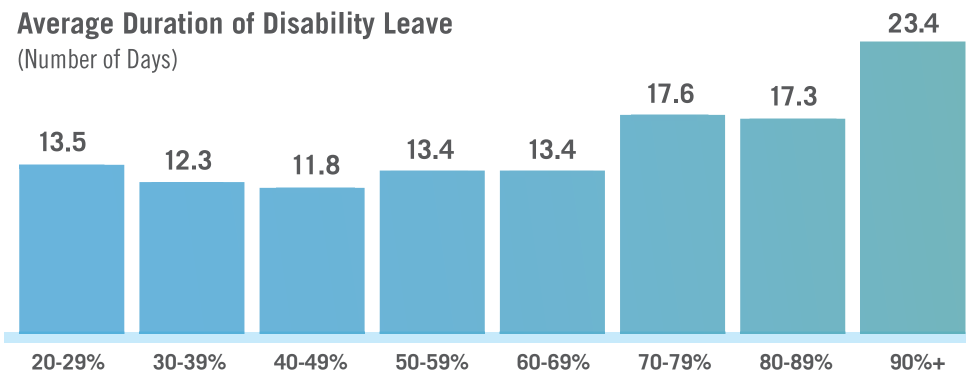
It is important for employers to understand the economics of a disability leave from the employee's perspective, and how that, in turn, can impact the employer's economics. For example, employees may not only lose a portion of their income, but may also incur out-of-pocket medical costs that cause financial stress if the benefits their employer provides are inadequate. To make ends meet, they may cease making DC plan contributions or even withdraw savings from their DC plans, which may result in delaying retirement. On the other hand, if employers offer benefits that are overly rich, they may unintentionally provide disincentives for employees to return to work as soon as they can. In an optimized benefit offering, employers strike a balance of providing adequate coverage without incentivizing the wrong behaviors.

To test this hypothesis, Prudential conducted an analysis of nearly 40,000 disability claims[13] to see whether there was a correlation between employees' ability to cover their monthly expenses during a disability leave and the duration of their long-term disability leave. The ability to cover expenses was estimated based on coverage levels and several other factors, such as income level and the presence of spousal income.

[12] Prudential, with supporting research and analysis conducted by the University of Connecticut's Goldenson Center for Actuarial Research in 2015/2016.
[13] Prudential research conducted in 2015 using Prutection Score[SM] methodology as described in "How Well Protected are Employees Against Key Financial Risks?," 2016.

Not surprisingly, the analysis showed a correlation between how well protected employees were against the financial risks of a disability and the duration of their disability leaves. As shown in the exhibit below, employees who were estimated to be able to cover only about half (50%–59%) of their monthly expenses while on disability leave had an average disability leave of 13.4 days. Those who were estimated to be able to cover most or all (90%+) of their expenses had a duration of 23.4 days.

Moreover, the economic impact to the employer is twofold. Since the employee segment that could cover most or all of its costs was also the segment with the highest average income, not only were durations longer for this segment, they were also more costly per day for the employer.



Preparedness Level: Percentage of Expenses Employees Are Able to Cover While on Disability

	20-29%	30-39%	40-49%	50-59%	60-69%	70-79%	80-89%	90%+
Average Coverage Level:	47%	62%	49%	62%	64%	65%	73%	71%
Average Salary:	$25k	$21k	$37k	$37k	$45k	$71k	$84k	$207k

In addition to coverage levels, the type of plan design may also impact employee behaviors. For example, critical illness and accident insurance plans generally fall into one of two broad categories – they either pay for specific treatments for critical illnesses or accidents, or they pay a lump sum upon occurrence of an incident. A treatment-based plan may encourage employees to use the full capabilities of the policy, even if not entirely necessary, and, as a result, may increase healthcare costs. An incident-based plan that is calibrated to the out-of-pocket costs of the healthcare plan may empower employees to decide how to use the lump sum most efficiently for recovery.

This means that employers who don't think carefully about their coverage levels and benefit plan designs may not only incur costs associated with decreased productivity, but also higher medical insurance expenses. The good news, however, is that employers can use data analytics to strike a balance that will put their benefits dollars to optimal use. For example, the excess premiums spent on overly rich plans, either by the employer or employee, can instead be deployed as contributions to DC plans to help employees retire on time. Plans should be calibrated to offer levels of coverage that are adequate to protect employees and relieve their financial stress, yet are not so excessive that productivity declines or healthcare costs increase.

Conclusion

To achieve the best possible outcomes from their benefit plans, employers should customize their plan design levers to successfully drive the desired behaviors among specific employee segments. Employers should also evaluate how the plans work together in a portfolio to identify any overlaps or gaps in coverage and interdependencies of one plan upon another. To help employers accomplish these efforts, data analytics represent a powerful tool to diagnose how plan designs are driving employee behaviors and impacting economic outcomes. Employers can be rewarded by delving deeper into how they analyze and customize benefit plan design to align with their objectives as cost effectively as possible. In essence, the details matter.

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