Business Case for Employee Benefits

Employee benefits have been and remain important to society as a whole, are necessary for individual employee's financial security, and support the employer's financial and workforce business needs. This article focuses on the business case for employee benefits from the perspectives of several different stakeholders: the employer that is often a plan sponsor, the public at large and the individual. The article discusses the perspective of each of these stakeholders and why benefits are useful from the perspective of that stakeholder. It starts with the business case and then provides supporting information.

by **Anna M. Rappaport** | *Anna Rappaport Consulting*

Financial security is provided by savings and benefit structures that are intended to replace income no longer earned during retirement and disability, benefits for survivors after the death of a breadwinner, and resources to finance health care. Resources come from a combination of personal and family effort, employee benefits provided through employers and public programs. In the United States, Social Security provides a base layer of income during retirement and during total and permanent disability, and Medicare helps finance health benefits for senior citizens and some long-term disabled.

There is disagreement about the most sensible roles for employers, individuals and public programs in providing security. At one extreme, it is believed that the individual should be totally responsible, and at the other, that public programs should take up most of the burden. Where existing programs and individual efforts fail, there are some additional social safety net supports, but these supports rarely move their beneficiaries out of poverty.

This article focuses on the business case for employee benefits. One can think about this matter from the perspective of several different stakeholders: the employer that is often a plan sponsor, the public at large and the individual. The article discusses the perspective of each of these stakeholders and discusses why benefits are useful from the perspective of that stakeholder. It starts with the business case and then provides supporting information.

Business Case for Benefits: Employer Perspective

Depending on the business, meeting employer business goals may be highly dependent on having the right human capital and keeping workers satisfied and motivated. Often, attraction and retention of employees are key business issues. The discussion of employer goals for retirement benefits below and the data provided demonstrate that employers are viewing the provision of these benefits as a key business issue, with attraction, retention and being competitive being the three top goals.

Employee benefits help attract and retain good employees. For many individuals, the availability of satisfactory health benefits is essential if they are to consider employment, and health benefits are often a consideration in leaving jobs as well. This may change in 2014, after the implementation of the Affordable Care Act.

Employers can improve the net welfare of their employees through offering benefits. Employee benefits are often tax-effective, so that a dollar spent on benefits gets more than a dollar of value for employees. Benefits provided on a group basis are generally more cost-effective than individual insurance. In addition, group purchase allows all employees to be covered, not just those in good health. Well-structured and -managed defined benefit plans generally get better investment returns than many defined contribution participants, and allow more dollars of retirement benefits to be delivered per dollar paid in. Benefits paid as guaranteed life income allow assurance that benefits will continue for life and provide more dollars of regular income than a relatively safe, self-managed periodic payout from an investment account. In many ways, a dollar spent on benefits gets more than a dollar of value for employees. Marketplace issues related to group vs. individual pricing are discussed below.

Maintaining a healthy workforce provides additional cost savings to employers when absenteeism and short-term disability claims are reduced. Providing retirement benefits allows employees a method to develop better financial skills and can assist employers when employees are less stressed by personal financial concerns.

Employee benefit programs provide an important way for employers to distinguish themselves from competitors.

Without benefits, employers can find themselves in a difficult situation if a long-term employee wants to retire but does not have resources, if an employee becomes severely disabled or if an employee is faced with catastrophic medical expenses.

Business Case for Benefits: Individual Perspective

Social Security provides a base layer of financial security for Americans, but alone it does not provide enough for financial security. The individual has choices: A person can seek a job offering employee benefits and participate to enhance security, and/or he or she can save independently for retirement and buy private insurance. For many people, financial security entails a combination of these options. Alternatively, they can choose not to protect themselves against financial risk and not to prepare for future needs.

Employee benefits are often a better choice than doing it on one's own for a number of reasons:

- A very large number of individuals do not have the knowledge, willpower and resources to do a good job for themselves on their own. The supporting information discusses individual perceptions and likely actions.
- Individually purchasing the different types of benefits offered by an employer requires several complex transactions for an individual in the open marketplace. The employer package is much easier for the employee to navigate and make choices from than purchasing the same benefits from the open marketplace.
- Employee benefits are usually more cost-effective due to group purchasing and professional management. Employer benefits often provide additional coverage for the employee's spouse and children on a cost-effective basis.
- Payroll deduction makes it easier to secure and maintain coverage.
- Automatic enrollment and default options in employer-sponsored benefit plans give employees the advantage of choice while, at the same time, making initial selections for them, so that no action is required to participate in programs. These features are very helpful for that part of the population who do not know what to choose, who are slow to act or who may forget to take the needed actions.
- The individual gets the value of the employer's professional management of the program, including selection of supporting investment services, negotiation for better pricing, monitoring of programs, etc.
- The employer has fiduciary liability to oversee programs, and that offers protection to employees.
- Employees in poor health may

not be able to get health and disability insurance on their own, or it may be prohibitively expensive.

- The marketplace provides a wider range of choices—and often better choices—to employers than to individuals.
- Employees who do not obtain professional advice may not know what they actually need, and employee benefits offer a structured solution, at least for part of what is needed.
- Employers often offer education and supporting services, such as limited advice or guidance.
- Employees can still supplement what they get in their benefit package with personal savings and individual insurance. They may even choose individual insurance instead of some parts of the program.

Business Case for Benefits: Societal Perspective

Social Security, Medicare and the rest of the social safety net are financially stretched. All face challenges in getting needed resources, and reductions in some of these programs are likely. The programs are certainly unlikely to be expanded.

When individuals are in financial trouble, added pressure is placed on the social safety net at the same time that less money is being collected in taxes to support the system. In addition, financially stressed people reduce their normal spending. The net result is that the economy worsens with a strong potential for a difficult repeating cycle downward.

One study provides an estimate of the societal value of benefits. When disability benefits are provided through the workplace, significant advantages accrue to the nation as a whole and to taxpayers. The study states that in the absence of employer-sponsored disability coverage, between 280,000 and 575,000 families would be paid public assistance on average of $8,100 per year. This would result in governmental outlays in the range of $2.25 million to $4.5 billion per year.[1] The economy as a whole also benefits from these employee benefits since the recipients have more money to spend and are more likely to buy goods and services in the marketplace. An employee earning $50,000 a year would have an estimated monthly Social Security disability benefit (SSDI) of $1,108 compared to a $2,500 monthly benefit in a plan with an average benefit level replacing 60% of predisability pay. These study results estimate the impact of disability based on the 31% of the civilian labor force who have employer-provided long-term disability benefits.[2]

There are similar issues for health care. When individuals do not have insurance, they often end up getting care in the emergency room rather than through a family physician. Such care costs a lot more than care provided in a more orderly way. Uncompensated care ends up costing everyone more for their health care.

The societal aspects of the business case for retirement benefits relate to the economy as a whole. If people can't afford to retire at the age when they expected to retire, that creates a troublesome situation for both employers and employees. If many people are poor in old age, that puts pressure on the social safety net and increases Medicaid and social service program costs. Poverty among the aged also means that they are buying fewer products and services, and the economy is less strong. It also means that many children are faced with their parents' problems, and some will choose to help them, sometimes at a great personal cost.

The National Institute on Retirement Security (NIRS) has studied how the receipt of defined benefit pensions impacts poverty and means-tested social assistance. NIRS estimates that without the defined benefit pensions they receive, an additional 4.7 million households would be poor or near-poor, and that governments in the United States would be spending an additional $7.9 billion per year on public assistance. That does not include Medicaid reimbursements, which would also increase. These estimates are made considering all U.S. households where the household head is aged 60 or older.[3] This study also finds that a significant part of the older population is receiving defined benefit pensions. In 2010, 28% of persons aged 60 and older were receiving defined benefit income from their own employment, and 43% of persons aged 60 or older were in households receiving defined benefit income from either their own employment or their spouse's employment. This had decreased from 34% and 52% in 1998. The median in-

TABLE

Business Goals for Retirement Security

Goals for Retirement Plans	% Very Important	% Somewhat Important	% Not Important	% Not Important
Be a competitive employer in our marketplace	81	17	1	1
Attract the right employees	82	16	1	1
Retain the right employees	80	18	1	1
Help employees build reasonable resources for retirement	58	38	1	3
Encourage employees to save more	57	39	1	3
Offer investment options that enable employees to get reasonable results from default options	56	38	2	4
Promote employee and retiree financial security	45	49	3	3
Help career employees to retire with adequate resources to maintain their preretirement living standards	41	46	3	10
Discourage use of funds too early	35	42	12	11
Facilitate orderly retirement	26	51	11	12
Assist employees in managing their retirement benefits after retirement	10	44	18	28
Provide continued pension accruals (or the equivalent to disabled employees)	8	31	18	43

Source: The Conference Board, Retirement Survey, May 2011.
Survey responses were received from 160 members of the Conference Board.

come from their own or their spouse's pension was $14,403 per year in 2010, up from $11,657 in 1998.[4]

Supporting Information: Employer Goals for Retirement Benefits

The employer, if a public company, has diverse business goals linked to various stakeholders including shareowners, employees and the public. At the time the Employee Retirement Income Security Act (ERISA) was enacted in 1974, the most common retirement benefit structure for medium and large employers was a defined benefit plan, which might be supplemented with an employer-sponsored savings plan. The traditional stated employer goals for retirement plans were heavily focused on helping long-term employees retire with dignity and supporting career employment. For the last 35 years, there has been a gradual shift from primary defined benefit plans to primary defined contribution plans and to greater employee responsibility. A 2011 survey from The Conference Board examined business goals for retirement security (Table).[5] This survey shows a dramatic shift away from a focus on employee security to a business focus on being competitive and attracting and retaining employees. These employer goals

A one-size-fits-all education plan may not work for your organization's employees. For instance, an organization with employees who are spread out over many different locations will have different communication needs than a company with a single office.

are completely consistent with the shift to defined contribution plans.

Supporting Information: Marketplace Issues

When financial security programs can be obtained through an employee benefit program, there are often advantages to the individual purchaser. When they must be purchased on an individual basis, there are issues for some people including insurability requirements, availability of coverage and higher costs.

Health status and individual insurance: The population is composed of individuals who range from very healthy people who are good insurance risks to those who are in poor health and are very poor insurance risks. If health and disability coverage are sold to individuals and are totally voluntary, then the insurance company will choose to insure only the healthier risks, or it may charge higher premiums to those who are not healthy. That means that the sickest people probably can't obtain coverage at all, or they pay a high price. Where coverage is offered through an employer, people are covered regardless of health status, and the costs are pooled over the entire group.

In theory, an alternative would be to offer coverage regardless of health status, but that would not work where there is voluntary coverage available, because too many people would not buy insurance until they were already sick. Then the cost would skyrocket, and the insurance would no longer be available.

Distribution issues: Individual insurance traditionally has been sold by agents and brokers who work individually with clients to understand their needs and then sell them insurance. Agents prefer dealing with more affluent customers, and the middle market and lower middle markets are underserved. The commission or other cost of the delivery is included implicitly in the product cost under most delivery methods. Other methods of distribution have been tried, but where the individual is purchasing independently without some type of sponsorship of the arrangement, there has been limited success to date. Purchase of financial products for risk protection, other than health insurance, is not a high priority for most individuals as discussed elsewhere in this article. The combination of the distribution system and individual preferences means that the use of individual risk protection products will be quite limited. Acceptance of risk protection is greater when offered through employer programs.

Supporting Research: How Well Are Individuals Handling Increased Responsibility?

Many individuals are not able to manage well on their own. Many people have inadequate resources for retirement and no disability coverage beyond Social Security. A growing body of knowledge on financial literacy documents concerns about financial literacy and the fact that many Americans lack basic math skills, knowledge of compound interest and basic knowledge about investment markets. The current situation will create added strains on social programs and leave many people without the resources to buy the products and services they have come to hope for as Americans.

For 15 years, the Society of Actuaries (SOA) has been conducting research on the postretirement period and public knowledge about management of retirement risk. This research has helped to identify gaps in knowledge about the risks, and how individuals think about managing these risks. The research provides insights about what is realistic to expect on the part of individuals as they manage risk in the new environment.

The 2009 SOA *Postretirement Risk Survey* focused on the process of planning and risk management. That survey shows that many retirees and near-retirees have a planning horizon shorter than their life span. Forty-nine percent of retirees and 37% of preretirees have a planning horizon of less than ten years. Only 13% of preretirees and 7% of retirees say that they look 20 years or more into the future when they plan. Throughout most of life, a planning horizon of less than ten years works pretty well, as people can react and adjust their plans as things happen. However, retirement resources must be accumulated before retirement to last throughout retirement, and a longer planning horizon is important. Understanding of life expectancy is linked to planning horizon. Many people underestimate life expectancy or do not understand what it is. Some people will die tomorrow or next month, but others will live to the age of 100 and beyond. Life expectancy provides an average of how long people at a particular age are expected to live. About half will live longer, and it is impossible to identify those people who will live long at earlier ages. At the age of 65, average life expectancy is 17 years for American men and 20 years for women. Thirty percent of women and 20% of men aged 65 can expect to live to the age of 90. Policy makers and decision makers need to remember that couple households need resources for the life of the longer-lived member of the couple.

SOA conducted focus groups with people who had retired in the last few years and found that some had not done a careful financial analysis or planned much at all.

Supporting Research: There Is Widespread Misunderstanding of the Economic Impact of the Death of a Spouse

Many people do not plan adequately for widowhood. An individual needs about 75% as much to live as a couple.[6] The majority (about six in ten) of respondents to the 2009 and 2007 SOA postretirement surveys indicate that they think the survivor will be about as well-off financially as before the death of his or her spouse. About the same number of people think that the survivor will be better off vs. worse off. Yet many widows have a decline in economic status after the death of their husbands. About four in ten older women living alone have virtually no money other than Social Security, subjecting them to poverty. There are a variety of ways to help protect spouses, including joint-and-survivor options for payment of pensions, life insurance, retaining asset balances that can be transferred to the survivor and long-term care insurance.[7] However, many people have not focused thoughtfully on the risk of needing long-term care, what it is likely to cost, the options for financing it and the resulting impact on them and their family.

Supporting Information: More Evidence About Disability Costs and Realities

Even though most Americans don't have long-term disability insurance, they run a high risk of becoming disabled at some point during their working careers. About one-third of workers between the ages of 35 and 65 will experience a disability that will last at least six months before they reach the age of 67. Statistics show that once an individual has been disabled for 90 days, he or she will remain disabled for an average of two years.[8]

For many households, the financial consequences of becoming disabled are dire. Indeed, there are few events that are more likely to adversely impact the financial security of working Americans than being unable to work due to illness or injury. Research shows that many American households are not ready to deal with the loss of income of a primary wage earner. In fact:

- 61% of Americans live paycheck to paycheck.
- Over 70% of American households could not pay their normal living expenses if a wage earner became disabled and unable to work for six months.
- More than three-quarters of

workers think that missing work for at least three months because of injury or illness would create a financial hardship, while half think it would cause a great hardship.
- Half of all households would have great difficulty raising $2,000 within a month, if needed.[9]

Unfortunately, despite the relatively high risk of disability and the inability of most families to withstand the economic impact of a disabled wage earner, most people are not insured against this risk. Those who don't have long-term disability must rely on a financial safety net that is often inadequate to meet a family's needs.

AUTHOR

Anna M. Rappaport, FSA, MAAA, is an actuary, consultant, author and speaker. She is a nationally and internationally recognized expert on the impact of change on retirement systems and workforce issues. Rappaport is a past president of the Society of Actuaries and chairs its Committee on Post-Retirement Needs and Risks. She formed Anna Rappaport Consulting in 2005 after retiring from Mercer Human Resource Consulting at the end of 2004, having served 28 years with the firm.

Conclusion

Research demonstrates that individuals are not well-equipped to manage financial security programs when left on their own. Financial advisors do not serve the middle market well. Social programs are under budget stress and likely to be reduced. Employers can provide benefits more efficiently and at a more attractive cost than individuals can on their own. Employee benefits have been and remain important to society as a whole, are necessary for individual employees' financial security, and support the employer's financial and workforce business needs. BQ

Endnotes

1. Research performed by Charles River Associates for Unum, "The critical need for financial protection: Landmark research on the economic value of employee benefits," July 2011.
2. National Compensation Survey. For more information, see www.bls.gov/ncs.
3. Frank Porell and Diane Oakley, *The Pension Factor*, National Institute for Retirement Security, 2012. Note that annual pension income considered in this study is pension income based on employment with a former employer and does not include any amounts paid as lump sums. This study uses SIPP data.
4. Ibid.
5. Anna M. Rappaport, *Fostering Financial Security in an Era of Individual Responsibility,* The Conference Board, Executive Action Series, 2012.
6. Author's estimate.
7. For more information on managing risks, see Society of Actuaries, *Managing Post-Retirement Risks: A Guide to Retirement Planning,* October 2011, at www.soa.org/files/pdf/post-retirement-charts.pdf.
8. Stephen Mitchell, June 2012 testimony delivered to the ERISA Advisory Council. Available on the U.S. Department of Labor's website at www.dol.gov/ebsa/pdf/AC1d.pdf.
9. Ibid.