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Excessive coverage levels may be counterproductive

Part 3 of a three-part series on benefits optimization insights

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An optimized benefit portfolio should strike the right balance of providing adequate coverage to relieve financial stress without motivating the wrong behaviors. (Photo: Thinkstock)

Employers increasingly rely on benefits optimization — designing benefit plans to maximize desired workforce outcomes, such as retirement readiness and productivity, against a given benefits budget — to wring the most out investments in employee benefits. To inform plan design, employers are also analyzing data to deepen their understanding of employees and predict their financial behaviors.

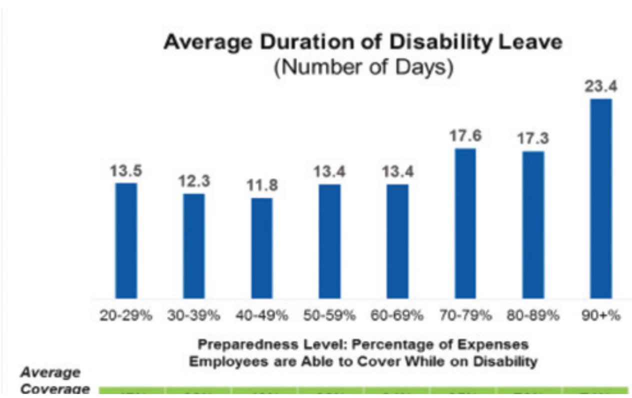
Benefits optimization can be applied to a plan and to a portfolio of benefits. The design of one benefit plan may impact other plans in the portfolio, so employers should take a holistic approach that considers the interdependencies. The following example illustrates the opportunity to optimize a benefit portfolio by focusing on protection coverage levels offered within the portfolio.

Maximizing productivity and retirement readiness

While inadequate protection during the working years may hurt retirement outcomes, overly generous protection coverage may also have unintended adverse consequences. An analysis of disability income insurance, which helps employees cover their basic monthly living expenses until they return to work from a disability leave, demonstrates this principle.

Employees without adequate disability coverage may suffer financial stress due to out-of-pocket expenses and the loss of a portion of their income. To make ends meet, they may stop contributing to, or withdraw savings from, their defined contribution (DC) plans, which may result in delaying retirement. But if employers offer benefits that are overly rich, they may unintentionally provide disincentives for employees to return to work as soon as they can.

To test this hypothesis, Prudential analyzed nearly 40,000 disability claims from an



Source: Prudential internal study in 2015. Click on chart to enlarge.

Excess premiums spent on overly rich plans, either by the employer or employee, can instead be deployed as DC plan contributions to help employees retire on time. (Photo: Thinkstock)

internal study in 2015. The company found a positive correlation between the durations of disability leave and employees' ability to cover their monthly expenses during leave. Employees who were able to cover only about half of their monthly expenses while on leave had an average leave of 13.4 days, versus 23.4 days for those who could cover most or all of their expenses.

The economic impact to the employer is two-fold: lower productivity and higher costs. Because employees who cover most or all of their costs were also those with the highest average income, not only were disability leave durations longer; they were also costlier per day.

A rich disability plan design has implications for other plans in a portfolio. For example, excess premiums spent on overly rich plans, either by the employer or employee, can instead be deployed as DC plan contributions to help employees retire on time.

An optimized benefit portfolio should strike the right balance of providing adequate coverage to relieve financial stress without motivating the wrong behaviors. Through data analytics, employers can find a balance that will put their benefits dollars to optimal use.

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