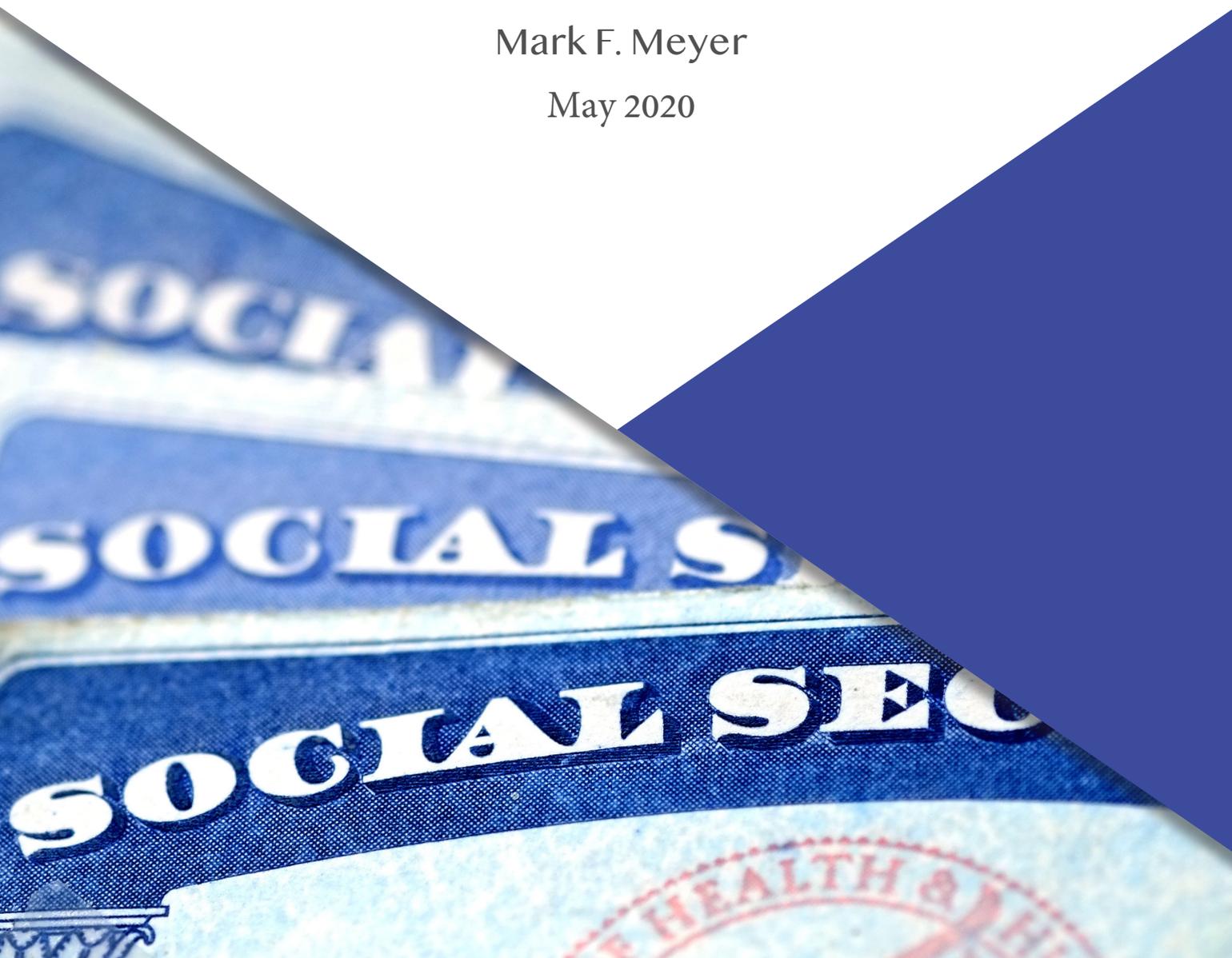




Automatic Enrollment in Private Group Disability Insurance: Evidence to Date and Prospects for the Future

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Abstract

Babbel & Meyer (2016) proposed that automatic enrollment programs for employer-sponsored private disability insurance (“PDI”) would increase participation in this coverage notably above current levels. Employees and employers benefit from PDI because it provides more financial support earlier than public disability insurance programs and offers return-to-work support. The increased participation in PDI would lead to a \$2 billion per year reduction in federal expenditures on the Social Security Disability Insurance, Medicaid, Medicare, and other programs by getting more affected individuals back to work sooner than would otherwise be the case.

This paper investigates the economic and institutional features in which automatic enrollment in PDI would operate. It first explains the fundamental economic considerations underlying employers’ decisions to hire and compensate employees, with a special focus on the allocation of compensation between salary and benefits and within benefit types. It notes that PDI competes for benefit dollars with more immediate perceived needs such as dental or vision coverage. The paper highlights how the relatively new areas of behavioral economics and “nudge theory” support the automatic enrollment in PDI programs. It points to the experience of automatic enrollment in 401(k) retirement savings programs as a meaningful example.

The paper then turns to an examination of the legal, institutional, and human factors affecting access to and participation in PDI. Laws and regulations have inhibited automatic enrollment programs. Automatic PDI enrollment must also be supported by employers’ human resources departments and their brokers, agents, and consultants. Federal legislation enabling automatic enrollment in PDI like that passed for 401(k)s in 2006 would increase employer and employee participation. In addition, PDI carriers, employer human resource departments, and benefit consultants should all encourage automatic enrollment in PDI coverage as the benefits to affected employees, their families, employers, and to certain government programs are compelling.

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Introduction

The Benefits of Private Group Disability Insurance

The probability that an individual of working age will suffer a health condition preventing that person from working for longer than a month is high. “The sobering fact for 20-year-olds is that more than 1-in-4 of them becomes disabled before reaching retirement age” (SSA 2019a).

A disabling incident can occur anywhere and at any time. It could be an accident at work, or on the way to work, or shopping, or working around the house, or on vacation. It could be caused by a relatively common virus where the body’s immune response is inadequate, or a treatment-resistant infection. It could arise from an unknown genetic condition that gets activated by an environmental circumstance or merely as an individual ages. Every currently healthy person faces the possibility of her or his health deteriorating to the point where normal, everyday functions are significantly impaired.

The first response to an impaired health condition, of course, is to get appropriate medical treatment. Private health insurance, when available, or public health insurance programs such as Medicaid and Medicare exist to pay those providing health care. Critical illness insurance may also be available to the affected individual.¹ But if the individual is employed, some of them will experience an extended period of unemployment during treatment and recovery. Medical insurance does not cover lost income during treatment and recovery.

The affected family might have savings to draw upon during this period, or there may be another person that can earn income. Most American families, however, have very limited savings to tide them through a period of no, or significantly reduced, income. Often, the other employed or potentially employable persons in the family may have to cease employment or reduce hours to care for the affected individual. If spouses were both working and one suffered a disabling incident, the loss of income could still be significant. This lack of income and savings during a period when the affected individual cannot work, particularly if the episode might be extended, places severe economic and emotional stress on the affected family. An extended period of unemployment due to poor health can deplete savings targeted for retirement, leading to financial stress in the future.

There are public sector programs designed to supply families with financial help, particularly to replace the income lost during a period of treatment and recovery from an adverse health condition. Chief among the public sector programs is Social Security Disability Insurance (“SSDI”). This program, however, generally replaces a relatively small portion of the income lost and requires months of waiting as the

¹ A type of policy that typically pays a stated face amount or lump sum if an insured person is diagnosed with a specific condition. This amount is paid regardless of any other sources of income and independent of any existing health or disability insurance coverage. It can be part of an accidental death and disability contract or a rider on a life insurance policy (Rubin 115).

individual works through the application and approval process.² Programs such as Temporary Assistance to Needy Families (“TANF”) and others are also available. Workers’ compensation payments may also be available, but these would be restricted to disabilities arising from the workplace. Sick leave and short-term disability insurance may also be available to affected employees, but by design these are limited in time.

Private disability insurance (“PDI”), particularly employer-sponsored long-term group disability coverage, is an important and meaningful supplement to private savings and public welfare programs. Long-term PDI is often integrated with short-term disability programs, and together they work to provide financial assistance to affected families early in the disability episode when it can significantly ease financial worries and stress. PDI can also provide substantially more financial assistance to families than the SSDI program. Over 70 percent of PDI programs surveyed, for example, replaced 60 percent or more of annual earnings. In March 2019, the median maximum monthly benefit amount was \$10,000 (BLS 2019b, Tables 29 and 30, private industry workers).

Perhaps as meaningful as the financial assistance provided by PDI coverage, private insurance carriers work with the affected individual (and family members), health care providers, and the employer to get the individual back on the job. This can entail specific therapies to aid and possibly speed recovery as well as working with the employers to implement workplace accommodations. As currently structured, the SSDI program provides little support to help affected individuals get back to work (Bardos, Burak, and Ben-Shalom 2015, 1-2). Moreover, the return-to-work support it can provide arrives months later than is possible under PDI coverage.³

In prior work, economists David F. Babbel and Mark F. Meyer outlined evidence that affected individuals covered by PDI programs return to work, or return to work more quickly, than individuals not covered by PDI (Babbel & Meyer 2016). They have also presented analyses and evidence that PDI coverage reduces federal and state expenditures on programs such as SSDI, Medicaid, Medicare, TANF, etc. (Babbel & Meyer 2013, Babbel et al. 2011).

Out of this analysis and evidence, Babbel & Meyer (2016) proposed that allowing for the automatic enrollment of employees into PDI would benefit affected employees and their employers by reducing

2 The average monthly SSDI payment for disabled beneficiaries between the ages of 30 and 34 in December 2018 was \$874.51. The median weekly earnings of workers between the ages of 25 and 34 was \$820. For this age group, therefore, SSDI replaced approximately 25 percent of median weekly earnings. Monthly SSDI payments to disabled beneficiaries between the ages of 50 and 54 in December 2018 averaged \$1,183.47. The median weekly earnings of workers between the ages of 45 and 54 was \$1,006. For this age group, therefore, SSDI replaced approximately 27 percent of median weekly earnings (SSA 2019b, 18 and BLS 2019a, Table 3, assuming an average of 4.33 weeks per month).

The standard waiting period for receiving benefits from SSDI is five months (SSA 2019b, 3). “The final award rate for disabled-worker applicants has varied over time, averaging 33 percent for claims filed from 2008 through 2017. . . . Denied disability claims have averaged 64 percent” (SSA 2019b, 155).

3 The SSDI program offers employment support provisions such as the “trial work period,” which allows a beneficiary to work and earn without losing benefits for up to nine months. The “extended period of eligibility” backstops work earnings with SSDI and Medicare benefits for up to 36 months. The “Ticket to Work” program provided participating beneficiaries the opportunity to obtain vocational rehabilitation services (SSA 2019b, 6, Ben-Shalom & Mamun 2015, Schimmel & Stapleton 2011).

financial stress and accelerating a return to work, as well as reducing federal and state expenditures on SSDI and other programs. They projected that increasing the portion of employees covered by PDI from approximately one-third in 2015 to between 50 and 55 percent could reduce federal expenditures on SSDI, Medicaid, Medicare, and TANF by at least \$2 billion per year as a result of the affected individuals recovering soon enough to avoid entering the SSDI system or exiting the SSDI system earlier. There would also be substantial savings for states.

In 2016, one of the major perceived impediments to automatic enrollment in PDI was uncertainty on the reach of state laws requiring written notice and assent for deductions from employees' payroll. In December 2018, the Department of Labor issued a letter holding that the Employee Retirement Income Security Act of 1974 preempted state laws on deductions for disability benefit programs, thereby clearing away some of the uncertainty regarding automatic enrollment in PDI.

Given the probabilities of an extended period of disability and the resulting deleterious effects of the financial stress, why did only 34 percent of private industry workers have access to long-term disability insurance programs in March 2019? (BLS 2019b, Table 16, private industry workers). This paper will take a closer look at the economics and institutional characteristics of private long-term disability insurance coverage in the United States in 2019 and offer some suggestions for increasing the proportion of workers covered by PDI.

The Economics of Employer Benefits, Focusing on PDI

The purchase of disability coverage from an insurance carrier means that those funds are not available for other uses. This is true whether the employer purchases the coverage for the employee or the employee pays directly for coverage sponsored by the employer. This section examines relevant fundamental economic considerations in the demand for disability coverage, incorporating, where appropriate, tax and institutional elements.

The Employers' Employment and Compensation Decisions

Anyone familiar with microeconomic principles knows that the standard condition for profit maximization is that production expands until the point where the incremental cost of producing the last unit(s) equals (but does not exceed) the incremental revenue of those last unit(s). In many cases this reduces to the proposition that the expected incremental cost of the last unit is no more than the revenue obtained on the last unit. Incremental cost includes all costs needed to make that last unit and, for our purposes, we will focus on the decision regarding the number of employees and their total cost. This means that the employer will hire employees until the cost of hiring the last one is no more than the revenue that employee will generate.

The total cost of an employee to the employer is more than the compensation reported on the IRS Form W-2. It includes the incremental costs of all benefits (vacation, holidays, sick time, medical insurance, retirement programs, etc.) plus the costs to equip and train the employee. So an employer considering hiring additional personnel will weigh the incremental cost of that hire against the expected incremental revenue

received because of the hire. This means that there is a limit to the amount that employers can spend hiring employees. If the cost of an employee benefit increases (e.g., an increase in health insurance premiums), the other components of employee costs must adjust to keep the incremental cost of employment below the incremental revenue. Alternatively, the productivity of the employees could increase (because of better equipment or training) or demand conditions could improve so that the employer obtains additional incremental revenue.

The simple economic condition outlined above can be expanded to cover more complicated – and realistic – employment situations. Allowing employment and production to occur over time, for example, increases the economic realism in the situation. The calculation gets a bit more complicated, but the basic condition continues to hold. An employer will hire workers as long as the present discounted value of the expected incremental employment costs are less than the present discounted value of the expected incremental revenue. More factors and terms are used in the calculation, but the principle remains the same.

Some activities are not motivated by the profit-maximizing objective or are so remote from the production and sales of a product or service that it is difficult to make a clear profit-maximizing connection for incremental employment. In the first category, you can place governmental and non-profit entities. In the second, you can think of overhead-related activities. Even in these situations, the incremental employment decision is determined by the perceived benefits relative to the expected costs. The perceived benefits often come in one of two forms. First, the new hire may directly contribute to attaining the objectives of the organization. This could be the case for governments or non-profits where the new hire directly provides services to the public. There are many possible examples of this, but one can certainly put law enforcement and not-for-profit medical care in this situation. Second, the new hire may allow existing resources, including existing employees, to work more efficiently. Again one can posit many different examples, such as an executive assistant for managers or information technology specialists. Employees such as these increase the effectiveness of other employees, thereby advancing the organization's objectives. The simple point here is that the expected (perceived) benefits of employing someone is inevitably compared to the costs of employing that person. From this point flow two further implications on the economics of the employment and compensation decision.

First, the economic conditions faced by employers place binding constraints on the number of employees hired and their compensation. Some employers operate under conditions where the amount that can be expended on employees is substantial, while others operate under conditions of very limited employee compensation. This condition is confirmed by the variation across organizational types in the percentage of organizations that offer their employees access to long-term disability insurance. For example, only 3 percent of private industry workers earning average wages in the lowest 10 percent of all workers have access to long-term disability insurance while 69 percent of private industry workers earning average wages in the top 10 percent have access to PDI (BLS 2019b, Table 16, private industry workers). As another example, 25 percent of private industry workers employed in firms with less than 100 employees have access to PDI, while 57 percent of private industry workers employed in firms with more than 500 workers have access to PDI (BLS 2019b, Table 16, private industry workers). Access to PDI is low in

construction (16 percent) but higher in manufacturing (48 percent), low in retail trade (12 percent) but high in utilities (88 percent), and low in leisure/hospitality (5 percent) but high in finance/insurance (78 percent) (BLS 2019b, Table 16, private industry workers). The provision of PDI as an employee benefit, therefore, depends partially on overall employment conditions in the industry.⁴

Second, the cost of providing benefits (such as PDI) competes with the costs of paying salary, taxes, and other benefits. In particular, the funds hypothetically used to purchase PDI can be applied to purchase other benefits or increase the take-home salary of the employee. That consideration is the subject of more detailed examination in the next section.

The Allocation of Compensation between Salary and Benefits, and within Benefits

The cost of employing a person consists of compensation costs as well as the costs of building, equipment, and training. Some portion of the total costs of employing a person remain with the employer in the sense that those costs are fungible across employees. The cost an employer incurs for an office or a cubicle or a vehicle or other equipment, for example, can be relatively easily transferred to other employees. These are not attached to specific employees, but they still enter into the overall employment and compensation decisions of the employer. Other elements of the total cost of employment are transferred irrevocably to specific employees. These are often considered as “compensation” costs. Compensation costs include salary as well as anything else that the employer might provide to employees to entice them to be, and remain, employed.

There are different elements of employee compensation, and the mix of the different types of compensation provided comes about based on a complex interaction of employee demand for certain types of compensation, the costs of supplying that type of compensation, and the treatment of that specific type of compensation by the tax code. Almost universally, the largest portion of employee compensation is salary. Out of the salary employees pay taxes, purchase goods and services for current consumption, repay debt, and save for the future. Employers, however, can and do structure total compensation packages to include certain benefits that they can provide on a group basis at a cost lower than the individual employee can purchase. For example, 67 percent of private industry workers have access to an employer-sponsored defined benefit or defined contribution (or both) retirement benefit program and 69 percent have access to an employer-sponsored health care program (BLS 2019b, Table 2 and Table 9, respectively, private industry workers). In both of these cases, certain tax considerations make it more attractive for employees to purchase these services through their employers. Also in both of these cases, there are certain cost efficiencies and advantages for the employer to design and implement programs with providers that cover all, or most, of its employees.

Other common employer-provided or employer-sponsored benefits include dental care (43 percent access), vision care (26 percent access), outpatient prescription drug coverage (67 percent access), life insurance coverage (56 percent access), short-term disability insurance coverage (42 percent access), and long-term disability insurance coverage (34 percent access) (BLS 2019b, Table 9 and Table 16, private industry workers).

⁴ This general pattern of lower benefit access rates for lower average wages and smaller employers also holds across other benefit categories (BLS 2019b, Table 2 for retirement benefits, Table 9 for healthcare benefits, and Table 31 for leave benefits, private industry workers).

Tax treatment affects the willingness and ability of employers to pay for benefits as well as the split between what the employer pays on behalf of their employees and what the employees voluntarily pay out of their take-home pay. If a benefit is tax-advantaged, meaning that the government allows a deduction for expenses or defers taxes on benefits, it is more likely to be offered, and offered at higher levels, by employers. It is also more likely to have a higher employee participation rate.

Medical insurance premiums are a good example of this. Medical insurance premiums paid through an employer program for employee coverage are tax-deductible expenses for the employers and employees, but individuals purchasing medical insurance outside of their employer program do not generally get to deduct those premium expenses from their income. This provides a strong incentive for people to obtain medical insurance coverage through their employers, assuming that the economic condition of the employer supports the payment of the medical insurance premiums.⁵

Defined contribution retirement savings programs are another tax-advantaged benefit. Deferrals of income into these programs are made before income taxes are calculated, and taxes on the deferrals and any returns are not payable until withdrawn, often decades later.

Other employee benefits are also tax advantaged. For example, employers can deduct premiums on group term life insurance policies for their employees up to a certain face value. Employees can purchase additional face value on the coverage on an after-tax basis.

This leads to a distinction between providing and sponsoring a benefit. If the employer provides a benefit, the employer pays for the benefit and that becomes a part of the employees' compensation that is not part of salary. If the employer sponsors a benefit, it will allow employees to participate in the benefit but the employees have to pay for it out of their salary. This payment can be on a pre-tax basis, such as a 401(k) or 403(b) program, or on an after-tax basis.

Employees have a choice regarding the tax treatment of PDI that is not available with a number of other benefit programs. Employees can have the premiums deducted on a pre-tax basis, much like a 401(k) program. If an employee then needs to access PDI benefits, those benefits are taxed as ordinary income. Alternatively, employees can pay premiums on an after-tax basis. PDI benefits received in this case are not taxed, resulting in higher usable income in the case of a disabling incident. The choice presented to an employee on the tax treatment of PDI is slightly higher current usable income if premiums are deducted on a pre-tax basis and benefits are taxed if received versus slightly lower current usable income if premiums are deducted on a post-tax basis and the benefits are not taxed. If an employee experiences a disability resulting in the payment of PDI benefits, the employee will obtain substantially more usable income if the benefits are not taxed. The choice, then, is between slightly lower current usable income in the situation of no disabling incident against a substantially higher usable income in the situation of a disabling condition. For most people, the best choice is to pay PDI premiums with after-tax income and obtain tax-free benefit payments in the case of a disability.

⁵ The Patient Protection and Affordable Care Act (2010) requires employers with more than 50 full-time employees to provide health insurance to their employees or pay a tax penalty. This employer mandate is intended to increase the number of employees covered by health insurance.

Overall, there is a two-stage process for providing or sponsoring employee benefits. In the first stage, the employer has to decide to provide or sponsor the benefit. If the employer is providing the benefit, the employer's economic circumstance must be such that it can afford to pay for the benefit, or at least the employer's portion of the benefit. If the employer is sponsoring the benefit, the employer has vetted and, in essence, endorsed the sponsored benefit as being valuable, at least potentially, to some of the employees. The employer's financial commitment to a sponsored benefit, however, is much lower than its financial commitment to a provided benefit.

In the second stage, the employee decides whether to participate and at what level. The primary determinants here are: (1) compensation paid to the employee (more highly compensated employees generally "purchase" more benefits), (2) employee preferences for current versus future consumption (a lower time value of money is associated with the "purchase" of more benefits with future payoffs), and (3) employee attitude towards risk (more risk averse employees will "purchase" more benefits that pay in adverse circumstances).

A common characteristic of many employee benefits is that they involve future, uncertain events. Employees generally do not know if (or when) they will get seriously ill or how much money they will need to save for a comfortable retirement. People value benefits received in the future less than current consumption. People have a difficult time determining the best course of action where future developments are uncertain. Under these circumstances, many knowledgeable observers posit that too many employees do not make sufficiently informed decisions about the best levels of participation in benefit programs (whose payouts are largely uncertain and in the future) compared to take-home pay (whose payouts are clear and immediate). For many employees, there is a strong drive to choose higher current take-home pay rather than purchase employee benefits that may be needed in the future. Certainly employees desire some level of retirement savings and health insurance, but the press of current needs may prompt them to participate at sub-optimal levels, perhaps in the hope that no one in their family needs more medical care than purchased, or that they can increase savings for retirement at a later point.

PDI is an employee benefit that might be declined in favor of current consumption if an affirmative election must be made. Even more likely, however, is an employee benefit such as vision or dental care being chosen instead of PDI. Many employees, especially those with families, know that they will need vision or dental care in the next year, and the costs of PDI, vision, and dental care are often very roughly of the same magnitude. Their employer may offer Section 125 flexible spending accounts for dependent or health care. Employees, therefore, have some level of choice between current take-home pay and employee benefits, and they also have choices among various employee benefits.

The amounts involved, regulations, and tax treatment determine the willingness and ability of employers to pay for benefits as well as the split between what the employer pays directly on behalf of the employee, the employee pays directly with pre-tax funds, and the employee pays directly with post-tax funds. Employers and employees make benefit decisions by trading-off dollars between the different types of benefits based on these factors, as well as their preferences for current versus future consumption and their risk tolerance. A brief and partial listing of the benefit decisions available is illustrative.

- Sixty-nine percent of all private industry workers have access to medical care benefits, and 71 percent of those having access choose to participate. For those employees choosing medical care coverage for their families, the average monthly premium exceeded \$1,600 in March 2019 – an average of \$1,056.86 paid by the employer and \$577.44 paid by the employee (BLS 2019b, Table 1, Table 9, Table 13, private industry workers). Medical care benefits, therefore, are quite costly, but they are tax-advantaged when purchased through an employer program. They are also highly valued when medical care is needed.
- Sixty-four percent of all private industry workers have access to a defined contribution benefit (e.g., 401(k) program), and 74 percent of those having access choose to participate (BLS 2019b, Table 2, private industry workers).⁶ Vanguard reports that the combined participant and employer contribution rate over the past 15 years averaged almost 10 percent of pre-tax salary (Vanguard 2019, 7). Generally, most of the contribution comes from the employee on a pre-tax basis. Over half of the plans at Vanguard offer an employer match on the employee contribution, averaging around 3 to 4 percent of salary (Vanguard 2019, 18-24). The amount of money involved in a defined contribution retirement benefit plan, therefore, can be substantial depending on the contribution rate chosen by the employee and the matching rate chosen by the employer. But the employee “owns” every dollar contributed to a 401(k) plan and will eventually receive it or pass it on to heirs. This is a very distinct feature of defined contribution plans.
- Forty-three percent of all private industry workers have access to dental care benefits, and 77 percent of those having access choose to participate (BLS 2019b, Table 9, private industry workers). Dental care premiums are generally quite inexpensive – roughly the same as PDI coverage premiums. And families need regular dental care.
- Twenty-six percent of all private industry workers have access to vision care benefits, and 80 percent of those having access choose to participate (BLS 2019b, Table 9, private industry workers). Vision care is not needed by everyone. Vision care premiums are also generally inexpensive – in the same approximate neighborhood as PDI premiums.
- Sixty-seven percent of all private industry workers have access to outpatient prescription drug coverage benefits, and 71 percent of those having access choose to participate (BLS 2019b, Table 9, private industry workers).
- Fifty-six percent of all private industry workers have access to life insurance benefits, and 98 percent of those having access participate (BLS 2019b, Table 16, private industry workers). The high participation rate here may be the result of group term life policies where the premiums are tax-deductible for face values up to \$50,000 in coverage. Employees are also able to purchase additional coverage but not on a tax-deductible basis.
- Forty-two percent of all private industry workers have access to short-term disability benefits, and 98 percent of those having access participate (BLS 2019b, Table 16, private industry workers). The high participation here likely reflects the nearly automatic provision of the benefit to employees from firms that offer the benefit.

⁶ Only 16 percent of private industry workers now have access to a defined benefit retirement benefits program (BLS 2019b, Table 2, private industry workers).

- As noted previously, 34 percent of all private industry workers have access to long-term disability benefits. Ninety-six percent of those having access participate (BLS 2019b, Table 16, private industry workers).
- Thirty-nine percent of all private industry workers have access to a dependent care flexible spending account, and 41 percent have access to a health care flexible spending account (BLS 2019b, Table 40, private industry workers). Participation rates for these benefits are not reported but are likely to be very high. These flexible spending accounts pay for goods and services that ordinarily would be purchased even without the benefit. The flexible spending accounts allow for those purchases using pre-tax funds, but the trade-off is that any unused amounts are forfeited by the employee participant.

The list above does not exhaust the employee benefits provided or sponsored by employers, and it certainly does not explain all the decisions that employers and employees have to make. Under these circumstances, various employee benefit programs meaningfully compete with each other, and also with take-home salary, for the compensation dollar. This plethora of decisions made under limited information and uncertainty about future events is the setting in which decisions about PDI provision and participation are made.

Behavioral Economics and “Nudge Theory”

A persistent criticism of the discipline of economics is that it posits human beings who are too rational and too informed. People do not have the ability or inclination to calculate all costs and benefits of a proposed course of action. People also do not know enough, particularly about events that will happen in the future. As a response to this criticism, insights from psychology (especially cognitive psychology), culture, and sociology are being integrated into an approach called “behavioral economics.” Many of these insights were inspired by detailed observations of actual human behavior in experimental settings and have been used to justify aspects of public policy.

While the limitations of standard microeconomic analyses have been acknowledged for years, progress on rigorously incorporating less-than-complete information and rationality into human decision-making advanced noticeably during the 1970s. Herbert Simon, for example, formulated the notions of “bounded rationality” and “satisficing,” from observations that humans often make suboptimal decisions when confronted with decisions (Simon 1972).⁷ Daniel Kahneman and Amos Tversky provided a major advance for decision-making under uncertainty with their development of “prospect theory” (Kahneman & Tversky 1979).⁸ Inspired by psychology experiments involving lotteries, prospect theory first posits that humans react to risk asymmetrically based on their initial position. More specifically, a financial loss reduces human satisfaction more than an equal financial gain increases it. It also posits that people are more concerned about rare events than more common events. Bounded rationality, satisficing, and prospect theory make human decision-making at least partially a function of anchoring and framing (a subjective interpretation

7 Herbert Simon was awarded the Nobel Memorial Prize in Economic Sciences in 1978 for “his pioneering research into the decision-making process within economic organizations.”

8 Daniel Kahneman was awarded the Nobel Memorial Prize in Economic Sciences in 2002 for “having integrated insights from psychological research into economic science, especially concerning human judgment and decision-making under uncertainty.” Amos Tversky died in 1996 and, therefore, could not be named a Nobel Laureate in 2002.

of current position) and heuristics (mental shortcuts or rules of thumb). In addition to addressing the limits of rationality and attitudes towards risk, behavioral economics also considers the trade-off between current and future choices. “Hyperbolic discounting” posits that people prefer smaller rewards sooner rather than larger rewards later. A consequence of this is that people make choices today that they would not have made in the future even with a clear understanding of the choices available (Ainslie 1975).

Building on these and other behavioral economics developments, Richard Thaler and Cass Sunstein proposed “nudge theory” (Thaler & Sunstein 2008).⁹ Thaler and Sunstein characterized “nudge” as follows:

A nudge, as we will use the term, is any aspect of the choice architecture that alters people’s behavior in a predictable way without forbidding any options or significantly changing their economic incentives. To count as a mere nudge, the intervention must be easy and cheap to avoid. Nudges are not mandates. Putting fruit at eye level counts as a nudge. Banning junk food does not.

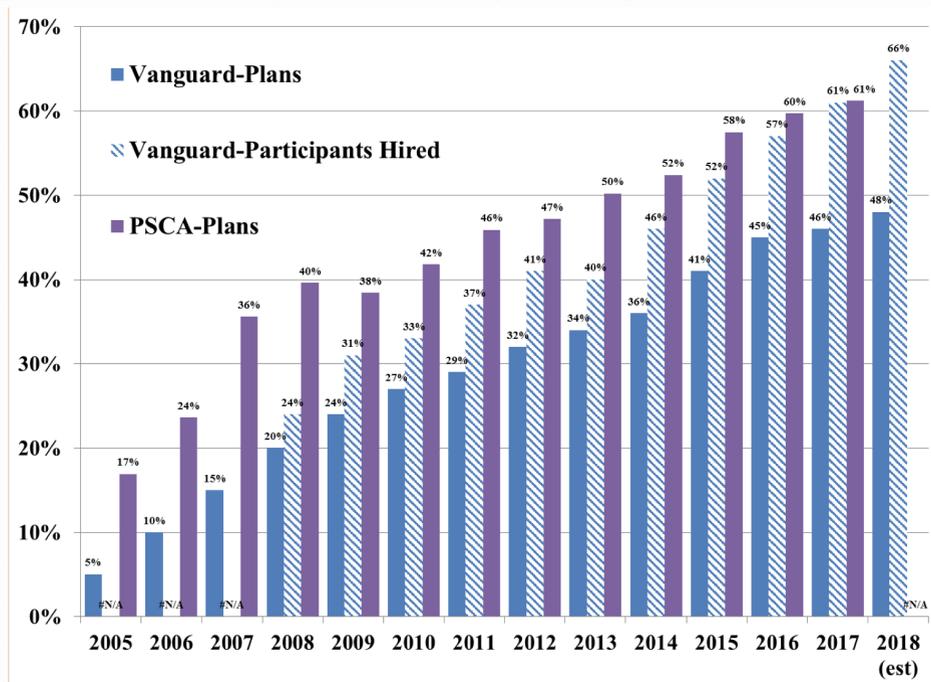
Nudge theory has been implemented primarily in the design of programs where choices have to be made. Nudging is less coercive than legislation or mandates but more forceful than education or exhortation. Thaler and Sunstein used the term “libertarian paternalism” to characterize the underlying philosophical ethos of nudge theory. “Libertarian” because people retain the ability to make choices, and “paternalism” reflecting a responsibility for the people making the choices. In public policy, nudging is accomplished in substantial part by restricting the set of choices available. This allows for a role for experts – those trained and informed enough to determine likely preferred future outcomes and how to design the available choices to attain those preferred outcomes. The expert(s) design the “choice architecture,” which presents the available choices to the people. People then choose from the available choices, which have been vetted and possibly prioritized by the choice architects.

Public policy focusing on influencing actions taken by people can work through a number of mechanisms. Certain actions can be prohibited or mandated. Requiring drivers to carry automobile insurance or employers to provide health insurance to employees is a type of “shove theory” – essentially forcing people to engage in certain transactions. Subsidies or tax incentives can be used to entice certain actions. Participation in 401(k) programs, especially those where the employer matches employee contributions, certainly encourages participation. Programs based on “nudge theory” have been used to encourage certain choices where participation is not mandated and, especially, to complement choices that are encouraged with tax incentives or subsidies.

Perhaps the best and most relevant example of nudge theory applied to public policy is in the area of participation in defined contribution retirement savings programs such as 401(k) and 403(b) programs. The experience here is highly informative for the proposal to automatically enroll employees into PDI.

⁹ Richard Thaler was awarded the Nobel Memorial Prize in Economic Sciences in 2017 “for his contributions to behavioural economics.”

Figure 1: Growth in 401(k) Plans and Participants Using Automatic Enrollment



Sources: Plan Sponsor Council of America various years; Moore 2018; Vanguard various years.

The Pension Protection Act (PPA) of 2006 facilitated mechanisms for employers to adopt automatic enrollment features in their 401(k) retirement savings programs (Employee Benefit Research Institute 2009, 191).¹⁰ The PPA allowed firms to enroll their employees into 401(k) programs automatically, but the employee could affirmatively “opt-out” of the enrollment. Since passage, automatic enrollment in 401(k) defined contribution plans has substantially increased.

As summarized in Figure 1, in 2006 less than a quarter of 401(k) plans surveyed by the Plan Sponsor Council of America (PSCA) had automatic enrollment. By 2017, over 60 percent of PSCA-surveyed plans had implemented automatic enrollment for their 401(k) plans. In 2006, only 10 percent of 401(k) plans with the Vanguard mutual fund group had automatic enrollment. By 2018, Vanguard reported that nearly half of their 401(k) programs had implemented automatic enrollment. From 2008 through 2018, the number of participants in automatic enrollment programs using Vanguard grew from 24 percent to 66 percent. Vanguard also reported that 401(k) plans with automatic enrollment had participation rates that were 50 percent higher than plans relying on voluntary enrollment (91 percent participation under automatic enrollment versus 60 percent under voluntary enrollment averaged over all Vanguard administered 401(k) plans) (Vanguard 2019, 35). While automatic enrollment increased participation rates in Vanguard 401(k) plans across all income and age categories, the increase in plan participation was higher for lower paid and younger employees. This is clear evidence that “nudging” via an automatic enrollment process did lead to substantially higher participation by employees in the 401(k) programs available to them.

¹⁰ The incentives cited included preemption of state laws that might inhibit the adoption of automatic enrollment and additional nondiscrimination safe harbor protections.

Legal, Institutional, and Human Factors Affecting Access to and Participation in Private Disability Insurance

In addition to the economic conditions described above, participation in employer-sponsored PDI coverage is affected by legal, institutional, and additional human factors. These are outlined below.

Laws and Regulations Inhibiting Automatic Enrollment Programs

Prior to December 2018, an employer automatically enrolling its employees into a disability insurance plan could potentially run afoul of state laws requiring employers to obtain written consent before withholding funds from employees' wages for the disability coverage. The uncertainty regarding the legality of automatic enrollment was perceived as a significant disincentive for employers to adopt automatic enrollment arrangements for PDI. The uncertainty was whether a specific provision of the Employee Retirement Income Security Act of 1974, ERISA Section 514(a), preempted state laws requiring the written consent of individual employees for withholdings from salary. On December 4, 2018, the Chief of the Division of Fiduciary Interpretations at the Department of Labor's Office of Regulations and Interpretations forwarded a letter to the Senior Vice President and General Counsel of the American Council of Life Insurers. After presenting an outline of the issue and summarizing some prior court and Department of Labor Advisory Opinions, the letter stated, "it continues to be the Department's view that a state law like those involved above advisory opinions [requiring written consent to deduct payments for disability insurance coverage] would be preempted by section 514(a) of ERISA to the extent the law is interpreted to limit, prohibit, or regulate an employer's adoption of automatic enrollment arrangements in connection with a disability benefit plan or other welfare benefit plan covered under Title I of ERISA, or making related deductions from wages for contribution to such a plan" (DOL 2018). The footnote in this letter, however, does note, "you did not ask and this letter does not address the types of notice and disclosure provisions that a plan fiduciary would need to adopt and implement for an automatic enrollment program to be operated consistent with the fiduciary's prudence and loyalty obligations under section 404 of ERISA."

This letter offers employers comfort that automatic enrollment into PDI coverage can be implemented by employers under ERISA, but it may not allay all employer concerns. Unlike the PPA for automatic enrollment in 401(k) plans, this letter does not have the force of statutory law and does not have the demonstration effect of Congressional, Senate, and Presidential approval. As the letter was issued in December 2018, there is little chance that employee benefit programs for 2019 incorporated this development. It will, however, be interesting to see if the letter increases adoption and participation in PDI coverage in future years.

The Role of Human Resources Departments

The human resources department in an organization plays a key role in the decision to offer access to PDI and in the employees' response to this offer. Working with mandates and directions from owners and management, the human resources department hires and retains the employees needed for the organization to function. They often have the primary responsibility for determining the overall specific configuration of compensation and employee benefits for the firm. Their success is measured by the recruitment, retention,

and advancement of firms' employees. They are constrained in this effort, however, by firm objectives and market conditions. In particular, employing firms can only provide those benefits that can be paid out of the revenue of the firm, recognizing that the firm revenue also has to cover all other ordinary and necessary expenses, or sponsor those benefits that employees can afford.

In addition to input into designing the compensation/benefits package(s), human resources departments also have a role communicating the benefit features to employees and helping them through the enrollment process. New employees are helped through this process as they start and existing employees have the chance to re-enroll and modify their elections at least once a year. The enrollment and re-enrollment process is a crucial stage for benefit selection. At that time, employees must review and absorb a substantial amount of important information and make choices that generally hold for a year. Some of the choices available to employees are quite constrained. If medical insurance is offered, for example, the employing organization has already determined a provider and the general contours of the coverage. The choices available to employees reduce to selections within the program already determined by the employer – individual or family coverage, amount of deductibles or copayments, etc. The choices available may also vary by the amount of premium paid by the employee. Similarly, if participation in a 401(k) or 403(b) defined contribution retirement savings program is offered, the employing organization will have selected the provider and the menu of available investments. Employees choose the dollar amount to defer into the retirement savings program and the allocation of that amount into specific investments. Some employers offer group life and accidental death & disability insurance. Once again, employers generally determine the provider and the default amount of insurance coverage.

The role of the human resources department here can be critical. They are deeply involved in designing the overall benefits package and their work is critical in communicating the features and costs of the benefit program and each element within it.¹¹ They have a key role in easing the employees through what can be an overwhelming number of decisions that have to be made regarding the benefit package. The human resources department can serve the role of the “choice architect” and “nudger” for employees selecting benefits.

The Role of Brokers/Agents/Consultants

Firms and their human resources departments often retain insurance brokers, agents, or consultants to design and help procure some parts of the organization's employee benefit services. Often, brokers, agents, and consultants are paid through a commission on product sales by the providers (more prevalent with smaller accounts) or a fee-for-service arrangement (generally with larger accounts). Under the commission situation, the more services a broker, agent, or consultant can bring to an employer, the higher the broker, agent, or consultant compensation. They may also be incrementally compensated in a fee-for-service situation, but here cementing or advancing their role as a “trusted advisor” to the client firm may lead to continued and expanded work.

¹¹ Organizations such as PDI carriers have invested in technology and personnel to help firms manage and implement portions of their human resource programs. To the extent that employee benefit programs such as maternity/paternity leave are mandated or encouraged by legislation or competition for employees, PDI carriers can offer a convenient and effective means to administer them.

One advantage an employee benefits broker/agent/consultant can bring to employing firms is broader and more contemporaneous information regarding choices other employing firms might be making in designing benefit packages. Assuming that the human resources department of the employing firm wants to attract and retain the appropriate talent, knowledge about the benefit packages of firms that might want to hire similar talent could be helpful. To the extent, therefore, that PDI is one of the insurance products that an employee benefits broker, agent, or consultant can present to an employing organization, it is more likely to be placed in the menu of employee benefits.

PDI, however, may face a specific disadvantage to being included in an employee benefit package as presented by brokers/agents/consultants. Compared to health insurance, retirement benefits, workers' compensation, etc., PDI is a relatively small dollar concern. The relatively small dollar amounts limit the compensation the broker/agent/consultant might be able to obtain for their work on PDI coverage and therefore arguably reduces the incentive of the broker/agent/consultant to promote the provision of PDI.

Timing is another issue for the introduction or expansion of PDI in employee benefits. Changes in employee benefit programs most often occur during a benefits enrollment period. For most employees, this occurs once a year, often at the end of one calendar year to be effective starting in the next calendar year. Major changes or innovations in employee benefits, including an initiative for automatic enrollment in PDI, therefore, need sufficient lead time for vetting and implementation. More specifically, the exact configuration of the PDI option, including any automatic enrollment feature, needs to be determined well before the annual benefits enrollment period.

The brokers/agents/consultants can bring substantial information to the human resource departments, functioning as a "choice architect" and "nudger" on elements of benefit packages to employers.

Suggestions to Increase Participation Rates in Private Group Disability Insurance Programs

The December 2018 letter from the Department of Labor confirming that ERISA preempted state laws that might prohibit automatic enrollment in PDI coverage was a very helpful development. While offering some comfort to employers contemplating automatic enrollment into PDI coverage for their employees, it does not have the force of legislation. There is some unknown level of risk that a future administration can reverse or otherwise modify this preemption determination and place employers at litigation risk for implementing automatic enrollment for PDI. Automatic enrollment for 401(k) programs was implemented through legislation, the Pension Protection Act of 2006. This has the force of statutory law instead of administrative rule-making and also provides a demonstration effect that Congress and the Executive would consider automatic enrollment into PDI programs another worthy public policy. Federal legislation explicitly permitting employers to automatically enroll their employees into PDI coverage programs would increase employer and employee participation in PDI.

Absent federal legislation, individual states may examine and address provisions in their laws and regulations that inhibit automatic enrollment into PDI. They could, for example, legislatively or administratively affirm that automatic enrollment can be used for PDI coverage.

The State of Maine has initiated an interesting experiment to expand participation in PDI. In 2016, the Maine legislature passed a bill that provides a \$50 per employee state tax credit to employers that establish approved PDI programs (H.P. 1051).¹² The process of obtaining approvals for the PDI policy forms was protracted and the program had a slow start. As of May 2019, “the number of taxpayers claiming the credit [was] fewer than 25 and the aggregate dollar value of the credit [was] less than \$10,000” (Private communication with Maine Bureau of Insurance). This initiative warrants continued monitoring and further investigation in the future.

PDI carriers should redouble their efforts in light of the Department of Labor letter to market the benefits of the coverage to employing firms. This would involve more contact with employing human resources departments as well as brokers/agents/consultants. PDI providers could work with professional organizations such as the Society for Human Resource Management, the American Council of Life Insurers, and America’s Health Insurance Plans. Previously, the Council for Disability Awareness compiled information and voiced the issues of PDI providers, but this organization has been on hiatus. It could be revived or its work could be sponsored by a different entity. PDI providers could make a concerted effort to present the coverage to insurance brokerage and agency conventions and work with actuarial societies. All this would be easier with additional legislative and regulatory clarity on automatic enrollment.

Conclusion

Private disability insurance currently helps alleviate the financial burdens of disability for millions of people. Approximately one-third of all private sector employees participate in some sort of private long-term disability insurance coverage. In addition to easing financial burdens, PDI providers facilitate therapy and work accommodations to get affected individuals back to their jobs. These capabilities not only benefit the affected individuals and their families, but also their employers. In addition, PDI eases substantial financial and administrative burdens on federal and state welfare programs such as SSDI, TANF, Medicaid, SNAP, and Medicare.

12 “This bill authorizes an employer to provide its employees a group disability income protection plan, which is a group policy instituted by an employer that provides income benefits to an employee who is unable to work for an extended period of time because of sickness or an accident. The group disability income protection plan may be either a short-term plan offering at least 6 months of benefits or a long-term plan offering at least 24 months of benefits. The premium paid by an employee for participation in an employer-sponsored group disability income protection plan is considered a premium that the employee has agreed to pay, as long as certain conditions are met.

An employer is entitled to a tax credit of \$50 for each employee enrolled in a group disability income protection plan after January 1, 2017. The credit may be taken by an employer for no more than 5 years” (H.P. 1051, Summary).

Given the benefits PDI offers to employees, employers, and governments, increasing adoption and participation in PDI would benefit more employees, employers, and governments. The economic conditions, institutional factors, legal regime, and human behaviors underlying the decisions to enroll, or not, in PDI coverage were outlined above. They are multifaceted and interact in a complex milieu. I see a clear role for legislation explicitly permitting automatic enrollment in PDI coverage programs to increase PDI adoption and participation overall. It clearly happened in the 401(k) environment. Such legislation would provide a demonstration effect and set in motion a chain of nudges working from the government to the PDI carrier, to the brokers/agents/consultants, to the human resource departments. More employers would offer PDI coverage and more employees would choose to participate.

The author of this paper is employed by Charles River Associates (CRA). The conclusions set forth herein are based on independent research and publicly available material. The views expressed herein are the views and opinions of the author only and do not reflect or represent the views of CRA, the Committee for a Responsible Federal Budget, or any other organization. Financial support was provided by the Committee for a Responsible Federal Budget. The author, CRA, and CRFB disclaim all liability of any kind whatsoever to any party arising in connection with this paper.

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About the McCrery-Pomeroy SSDI Solutions Initiative

The McCrery-Pomeroy SSDI Solutions Initiative is a project dedicated to identifying practical policy changes to improve the Social Security Disability Insurance (SSDI) program and other policies for people with disabilities. Launched in 2014, the initiative originally commissioned a number of accomplished policy experts from a variety of backgrounds to put forward 12 different policy proposals, each addressing a unique issue with current disability policy. These papers were peer-reviewed, presented at the Initiative's 2015 SSDI Solutions Conference, and ultimately published in the 2016 book [SSDI Solutions: Ideas to Strengthen the Social Security Disability Insurance Program](#). The Initiative's work helped to elevate SSDI to the attention of policymakers and has led to the proposal, enactment, and implementation of numerous legislative and regulatory improvements.

Beginning in 2018, the SSDI Solutions Initiative commissioned seven additional papers designed to build upon the work of the 2016 book. These papers will present additional research, offer implementation guidance, or offer new ideas to further improve disability policy in the United States.

The SSDI Solutions Initiative is co-chaired by former Congressmen Earl Pomeroy (D-ND) and Jim McCrery (R-LA), both former Chairmen of the House Ways & Means Social Security Subcommittee. The SSDI Solutions Initiative is a project of the Fiscal Institute at the Committee for a Responsible Federal Budget.

More information about the SSDI Solutions Initiative is available at <http://www.SSDISolutions.org/>.

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