

# Chapter Thirteen

## Benefit Options

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### A Historical Perspective

The idea of employee benefits in the United States dates back to colonial days. Plymouth Colony settlers established a retirement program in 1636 for the military. American Express began the first private pension plan in 1875. Montgomery Ward, a now defunct competitor of JC Penneys, started the first group health and life insurance programs in 1910. In 1915, employees in the iron and steel industry worked a standard 60 to 64 hours per week. By 1930 that schedule had been reduced to 54 hours. It was not until 1929 that the Blue Cross concept of prepaid medical costs was introduced. Before that health care was the responsibility of the worker's family. Prior to 1935 only one state (Wisconsin) had a program of unemployment compensation benefits for workers who lost their jobs through no fault of their own. Before World War II very few companies paid hourly employees for holidays; in most companies employees were told not to report for work on holidays and to enjoy the time off, but their paychecks were smaller the following week.<sup>1</sup>

The biggest early push for benefits, though, came from Uncle Sam. In 1935 the federal government mandated retirement income protection under Social

Security. Coverage for the disabled and elderly followed in the 1950s and 1960s. Fast forward 50 years and companies are now reeling from the high cost of benefits, especially health care costs. And some of the measures to cut these costs are attracting public attention. For example, companies like PepsiCo, General Mills, and Northwest Airlines charge \$20-\$50 a month extra for smokers.<sup>2</sup> Twenty-one states even allow companies to discriminate against smokers in hiring. "You smoke? Sorry, no job for you."<sup>3</sup> The argument runs, if you're going to continue habits that raise our health insurance costs, we're going to charge you. Going even one giant step further, Walmart distributed an internal memo to the Board of Directors proposing that health care costs could be cut dramatically by discouraging unhealthy people from applying.<sup>4</sup> Illegal, includes as a task in every job description that employees must take their turn at rounding up shopping carts in the parking lot? If even a few unhealthy health care provider WellPoint Inc says just 7 percent of its 29 million customers account for 63 percent of its medical costs. Add to these snippets of reality the explosion of ongoing research on the human genome, and we aren't very far away from a time when a company could test applicants for a disposition to contract fatal diseases—years in the future! Employers intent on reducing health care costs need only refuse to hire these future insurance risks.

All of these scenarios make the study of employee benefits far more interesting. Desperate to even slow the ever-growing cost of employee health insurance and other benefits, companies are experimenting with different, and sometimes radical, methods to entice, bribe, and even threaten. At the very least, this makes the study of benefits more exciting. Happy reading!

For years we've asked our students and HR professionals to rate different kinds of rewards in terms of importance. Usually, at least in the past, employee benefits lagged behind such rewards as pay, advancement opportunity, job security, and recognition. Recently, though, we've noticed a dramatic shift in this admittedly unscientific poll. As benefits costs, especially health care, have skyrocketed, so has their popularity. A recent survey listed the top four rewards contributing to employee satisfaction. And, they are compensation, benefits, job security, and work/life balance.<sup>5</sup>

With this increased popularity comes a need for HR professionals to understand what benefits are important to employees. Just ask Rich Floerssch, the executive vice president for human resources at McDonald's Corporation. "As we noted in Chapter 12, several years ago McDonald's unveiled a new benefits program for crew members. When we asked Rich why McDonald's was modifying its health care package as part of a total benefits upgrade, he cited the rising value of benefits to workers and the strategic importance of its 750,000 plus workers. Look at it from another perspective: The population (and your three favorite authors) are aging. This alone changes the pattern of preferences. We're not sure all companies are as attuned to changing preferences as McDonald's. For example, a McKinsey Survey reports 89 percent of CEOs think benefits are extremely or very important to attracting and retaining employees. However, less than one-half of these executives thought they understood what benefits employees

**EXHIBIT 13.1** Employer Cost of Benefit per Hour Worked: Private Sector and State/Local Government

| Benefit Type                  | Private Sector<br>Average (\$) | State and Local<br>Government Avg (\$) |
|-------------------------------|--------------------------------|----------------------------------------|
| Holiday                       | .63                            | .95                                    |
| Vacation                      | 1.08                           | 1.19                                   |
| Sick leave                    | .28                            | .84                                    |
| Personal leave                | .11                            | .23                                    |
| Life insurance                | .04                            | .06                                    |
| Health insurance              | 2.36                           | 5.09                                   |
| Short Term Disability         | .06                            | .03                                    |
| Long Term Disability          | .05                            | .04                                    |
| Retirement                    | 1.15                           | 4.42                                   |
| Social Security & Medicare    | 1.75                           | 1.95                                   |
| Workers' Compensation         | .42                            | .54                                    |
| Selfed Unemployment Insurance | .27                            | NA                                     |

Source: Employer Costs for Employee Compensation, December 2014. Bureau of Labor Statistics. USDL-15-1386.

wanted. Moreover, almost 60 percent of these executives admitted they never assessed whether benefits were helping the company achieve its strategic goals.<sup>8</sup> Is it any wonder that daily news reports bring frequent alarms about the rising cost of benefits?

Our goal in this chapter is to give you a clearer appreciation of employee benefits. Let's start by comparing wages to benefits. In December of 2014 private industry wages averaged \$21.72 (69.4%). Benefits Averaged \$9.60 (30.6%). In the past four years benefits have risen as a percent of total compensation cost from 29.2 to 30.6 percent. While 1.4 percent rise doesn't seem like much, it highlights the continuing relative growth in benefits costs over the past several decades. Comparable figures for state and local government employees were \$43.95 (68.4%) per hour for wages and \$15.78 (31.6%) for benefits. Notice both wages and benefits are higher in the public sector jobs; it pays to work for the government! A breakdown of benefits in Exhibit 13.1 shows the relative costs.

Many students tell us they are struck by how low the Retirement and Health Insurance figures are for the private sector, especially in comparison to the Public Sector figures and also considering how much coverage the press devotes to these two benefits. The follow-up question we get is "doesn't everyone get a retirement package?" The answer is No! Many Americans work in jobs with no paid retirement. The same thing is true for health coverage. The insurance figures in this exhibit would be much higher if more organizations provided health-care insurance.

One way to get your attention is to show the dramatic increase in costs of benefits. Back about the time the first McDonalds opened (mid-1950s), benefits cost \$18 billion. Today that figure is \$5 trillion and change! If for no other reason than cost escalation, we need to understand the world of employee benefits. Let's begin by looking at a widely accepted categorization of employee benefits (Exhibit 13.2). The U.S. Chamber of Commerce issues an annual update of benefit expenditures.<sup>9</sup> This report identifies seven categories of benefits in a breakdown that is highly familiar to benefit

**EXHIBIT 13.2** Categorization of Employee Benefits

| Type of Benefit                                                                                                          |
|--------------------------------------------------------------------------------------------------------------------------|
| 1. Legally required payments (employers' share only)                                                                     |
| a. Old-age, survivors, disability, and health insurance (employer FICA taxes) and railroad retirement tax                |
| b. Unemployment compensation                                                                                             |
| c. Workers' compensation (including estimated cost of self-insured)                                                      |
| d. State sickness benefit insurance                                                                                      |
| 2. Retirement and savings plan payments (employers' share only)                                                          |
| a. Defined benefit pension plan contributions (401(k) type)                                                              |
| b. Defined contribution plan payments                                                                                    |
| c. Profit sharing                                                                                                        |
| d. Stock bonus and employee stock ownership plans (ESOPs)                                                                |
| e. Pension plan premiums (net) under insurance and annuity contracts (insured and trusted)                               |
| f. Administrative and other costs                                                                                        |
| 3. Life insurance and death benefits (employers' share only)                                                             |
| 4. Medical and medical-related benefit payments (employers' share only)                                                  |
| a. Hospital, surgical, medical, and major medical insurance premiums (net)                                               |
| b. Retiree hospital, surgical, medical, and major medical insurance premiums (net)                                       |
| c. Short-term disability, sickness, or accident insurance (company plan or insured plan)                                 |
| d. Long-term disability or wage continuation (insured, self-administered, or trust)                                      |
| e. Dental insurance premiums                                                                                             |
| f. Other (vision care, physical and mental fitness benefits for former employees)                                        |
| 5. Paid rest periods, coffee breaks, lunch periods, wash-up time, travel time, clothes-change time, get-ready time, etc. |
| 6. Payments for time not worked                                                                                          |
| a. Payments for or in lieu of vacations                                                                                  |
| b. Payments for or in lieu of holidays                                                                                   |
| c. <b>Sick leave pay</b>                                                                                                 |
| d. Parental leave (maternity and paternity leave payments)                                                               |
| e. Other                                                                                                                 |
| 7. Miscellaneous benefit payments                                                                                        |
| a. Discounts on goods and services purchased from company by employees                                                   |
| b. Employee meals furnished by company                                                                                   |
| c. Employee education expenditures                                                                                       |
| d. Child care                                                                                                            |
| e. Other                                                                                                                 |

Source: U.S. Chamber of Commerce, Employee Benefits Study 2008, <http://www.uschamber.com/research/benefits.htm>. Reprinted with permission.

plan administrators. These seven categories will be used to organize this chapter and illustrate important principles affecting strategic and administrative concerns for each benefit type.

Exhibit 13.3 shows employee participation in selected benefit programs. As expected, the highest access is to health insurance and retirement benefits. With passage of the Affordable Care Act expect the access to health insurance to rise considerably.

**EXHIBIT 13.3****Access to  
Selected  
Benefits**

Source: 2014  
National  
Compensation  
Survey, Bureau of  
Labor Statistics.  
<http://www.bls.gov/nsc/dbs/data>.

| Benefit                   | Civilian Employees |  |
|---------------------------|--------------------|--|
|                           | 75%                |  |
| Paid holiday              | 74                 |  |
| Paid vacation             | 65                 |  |
| Paid sick leave           | 36                 |  |
| Short-term disability     | 72                 |  |
| Health insurance          | 40                 |  |
| Life insurance            | 68                 |  |
| Retirement                | 25                 |  |
| Defined benefit plan      | 56                 |  |
| Defined contribution plan | 47                 |  |
| Dental insurance          | 26                 |  |
| Vision care               | 11                 |  |
| Childcare                 | 39                 |  |
| Wellness programs         |                    |  |

**LEGALLY REQUIRED BENEFITS**

Virtually every employee benefit is somehow affected by statutory or common law (many of the limitations are imposed by tax laws). In this section the primary focus is on benefits that are required by statutory law: Workers' Compensation, Social Security, and Unemployment Compensation.

**Workers' Compensation**

What costs employers \$83.2 billion a year and is a major cost of doing business? Answer: workers' compensation.<sup>10</sup> Of this total, \$31.8 billion was for medical care and the remainder was paid as cash benefits.<sup>11</sup>

As a form of no-fault insurance (employees are eligible even if their actions caused the accident), workers' compensation covers injuries and diseases that arise out of, and while in the course of, employment. Benefits are given for:<sup>12</sup>

1. Medical care needed to treat the job injury or illness.
2. Temporary disability benefits to the employee to help replace lost wages.
3. Permanent disability payments to the employee to compensate for permanent effects of the injury.
4. Survivor death benefits.
5. Rehabilitation and training in most states, for those unable to return to their prior career.

Workers' compensation costs vary over time. During the early years of this century, the costs rose. But as recently as 2005, the dollar costs began to decline. Costs in recent years have been the lowest since 1980.<sup>13</sup> Experts believe part of this stabilization relates to employer safety programs, with far fewer fatal accidents occurring and somewhat higher incidents of minor, less costly accidents.

States vary in the size of the payout for claims. New York State, for example, has a payout formula for totally or partially disabled that is based on his/her average weekly wage for the previous year. The following formula is used to calculate benefits:

 **$2/3 \times \text{average weekly wage} \times \% \text{ of disability} = \text{weekly benefit}$** 

Therefore, a claimant who was earning \$400 per week and is totally (100%) disabled would receive \$266.67 per week. A partially disabled claimant (50%) would receive \$133.34 per week.<sup>14</sup>

Some states provide "second-injury funds." These funds relieve an employer's liability when a pre-employment injury combines with a work-related injury to produce a disability greater than that caused by the latter alone. For example, if a person with a known heart condition is hired and then breaks an arm in a fall triggered by a heart attack, medical treatments for the heart condition would not be paid from workers' compensation insurance; treatment for the broken arm would be compensated.

Workers' compensation is covered by state, not federal, laws. For details on each state's laws, go to the e-Compensation website below:

**e-Compensation**

Each state differs in its workers' compensation law. If you're a glutton for punishment, visit [www.workerscompensation.com/workers\\_comp\\_by\\_state.php](http://www.workerscompensation.com/workers_comp_by_state.php) (visited April 22, 2015).

As Exhibit 13.4 shows, in general the states have fairly similar coverage, with differences occurring primarily in benefit levels and costs. In recent years states have made significant changes in Workers' Compensation (WC) designed to reduce costs. For example, Montana paid \$3.22 per \$100 of payroll cost, a figure much higher than most states. They and five other states passed major reforms attempting to control medical costs and rein in WC as a result.<sup>15</sup> In the following four years the per \$100 of payroll cost dropped as follows: 3.06, 2.76, 2.54, 2.49.

**e-Compensation**

This website from the Department of Labor provides extensive information about legally required benefits and specific requirements for compliance: <http://www.dol.gov/dol/topic/>

**EXHIBIT 13.4 Commonalities in State Workers' Compensation Laws**

| Issue                   | Most Common State Provision                                                                                                                                                                                                                                                                                                                      |
|-------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Type of law             | Compulsory (in 47 states)<br>Elective (in 3 states)                                                                                                                                                                                                                                                                                              |
| Self-insurance coverage | Self-insurance permitted (in 48 states)<br>All industrial employment<br>Farm labor, domestic servants, and casual employees usually exempted<br>Compulsory for all or most public sector employees (in 47 states)<br>Coverage for all diseases arising out of and in the course of employment<br>No compensation for "ordinary diseases of life" |
| Occupational diseases   |                                                                                                                                                                                                                                                                                                                                                  |

Source: [www.dol.gov](http://www.dol.gov).

### Social Security

When Social Security was introduced in 1937, only about 60 percent of all workers were eligible.<sup>16</sup> Today, nearly every American worker (96%) is covered.<sup>17</sup> Whether a worker retires, becomes disabled, or dies, Social Security benefits are paid to replace part of the lost family earnings. Ever since its passage, the Social Security Act has been designed and amended to provide a foundation of basic security for American workers and their families. Exhibit 13.5 outlines the initial provisions of the law and its subsequent broadening over the years.<sup>18</sup> In combination this law and its updates provide coverage in the form of: Retirement insurance; Survivors insurance; Disability insurance; Hospital and medical insurance for the aged, the disabled, and those with end-stage renal disease; Prescription Drug Benefit Extra Help with Medicare Prescription Drug Costs Supplemental security income; and Special Veterans Benefits.<sup>19</sup>

The money to pay these benefits comes from the Social Security contributions made by employees, their employers, and self-employed people during working years.

**EXHIBIT 13.5** Changes in Social Security over the Years

|           |                                                                                                                                                                                                                                                                                                                                  |
|-----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1939      | Survivor's insurance was added to provide monthly life insurance payments to the widow and dependent children of deceased workers.                                                                                                                                                                                               |
| 1950–1954 | Old-age and survivor's insurance was broadened.                                                                                                                                                                                                                                                                                  |
| 1956      | Disability insurance benefits were provided to workers and dependents of such employees.                                                                                                                                                                                                                                         |
| 1965      | Medical insurance protection was provided for the aged, and later (1973) for the disabled under age 65 (Medicare).                                                                                                                                                                                                               |
| 1972      | Cost-of-living escalator was tied to the consumer price index—guaranteed higher future benefits for all beneficiaries.                                                                                                                                                                                                           |
| 1974      | Existing state programs of financial assistance to the aged, blind, and disabled were replaced by SSI (supplemental security income) administered by the Social Security Administration.                                                                                                                                         |
| 1983      | Effective 1984, all new civilian federal employees were covered. All federal employees covered for purpose of Medicare.                                                                                                                                                                                                          |
| 1985      | Social Security Administration (SSA) became an independent agency administered by a commissioner and a bipartisan advisory board.                                                                                                                                                                                                |
| 1994      | Amendments were enacted imposing severe restrictions on benefits paid to drug abusers and alcoholics (together with treatment requirements and a 36-month cap on the payment of benefits).                                                                                                                                       |
| 1996      | Contract with America Advancement Act of 1996 (CWAADA) was enacted, eliminating substance abuse as a disabling impairment. Substance abuse may no longer be the basis for a finding of disability.                                                                                                                               |
| 2000      | Depression-era limits on amount of money that workers age 65 to 69 may earn without having their Social Security benefits reduced were eliminated—retroactive to January 1, 2000. The rules governing individuals who take early retirement at age 62 and the status of workers age 70 and over were not changed by the new law. |
| 2003      | <b>The Medicare Prescription Drug, Improvement and Modernization Act of 2003</b> (P.L. 108-173) archive. Seniors must choose from among a variety of plans written in bureaucratic hieroglyphics.                                                                                                                                |

Source: [http://www.ssa.gov/OP\\_Home/handbook/handbook-11.html](http://www.ssa.gov/OP_Home/handbook/handbook-11.html), June 10, 2009.

**EXHIBIT 13.6** Trends in Social Security Taxes 1980–2009

| Year      | OASI (All But Health)                                  |                                                                  | Health Component  |                          | Total Contribution      |
|-----------|--------------------------------------------------------|------------------------------------------------------------------|-------------------|--------------------------|-------------------------|
|           | Maximum Taxable Earnings                               | % OASI (Old Age Survivors)                                       | % DI (Disability) | Maximum Taxable Earnings | %                       |
| 1980      | \$25,900                                               | 4.52                                                             | 0.56              | \$25,900                 | 1.05                    |
| 1990      | 51,300                                                 | 5.6                                                              | 0.6               | 51,300                   | 1.45                    |
| 1995      | 61,200                                                 | 5.26                                                             | 0.94              | No max                   | 1.45                    |
| 1997–1999 | Increases with market wage movement                    | 5.35                                                             | 0.85              | No max                   | 1.45                    |
| 2000+     | Increases with market wage movement—\$117,000 in 2014. | 5.3                                                              | 0.9               | No max                   | 1.45                    |
|           |                                                        | In 2011 the total tax was reduced for one year from 6.2% to 4.2% |                   |                          | 7.65                    |
|           |                                                        |                                                                  |                   | No max, uncapped health  | No max, uncapped health |

Source: U.S. Social Security Administration Office of Retirement and Disability Policy, [www.ssa.gov/policy/docs/guides/taxprog\\_highlights/index.html](http://www.ssa.gov/policy/docs/guides/taxprog_highlights/index.html), April 6, 2015.

As contributions are paid in each year, they are immediately used to pay for the benefits to current beneficiaries. Herein lies a major problem with Social Security. While the number of retired workers continues to rise (because of earlier retirement and longer life spans), no corresponding increase in the number of contributors to Social Security has offset the costs. Combine the increase in beneficiaries with other cost stimulants (e.g., liberal cost-of-living adjustments) and the outcome is not surprising. To maintain solvency, there has been a dramatic increase in both the maximum earnings base and the rate at which that base is taxed. Exhibit 13.6 illustrates the trends in tax rate, maximum earnings base, and maximum tax for Social Security.

Several points immediately jump out from this exhibit. First, with the rapid rise in taxable earnings, you should get used to paying some amount of Social Security tax on every dollar you earn. This wasn't always true. Notice that in 1980 the maximum taxable earnings were \$25,900. Every dollar earned over that amount was free of Social Security tax. Now the maximum is over \$110,000, and for one part of Social Security (Medicare) there is no earnings maximum.<sup>20</sup> If Jordan Spieth makes \$30 million this year, he will pay 7.65 percent social security tax on the first \$117,000 and 1.45 percent (the health/Medicare portion) on all the rest of his income. For the super rich (even with royalties, textbook authors need not apply), this elimination of the cap is costly.

Second, remember that for every dollar deducted as an employee's share of social security, there is a matching amount paid by employers. For an employee with income

in the \$70,000 range, this means an employer contribution of just under \$6,000. Because Social Security is retirement income to employees, employers should decrease private pension payouts by a corresponding amount.

Current funding levels produced a massive surplus throughout the 1990s. There is still, at least in accounting terms, a huge surplus (perhaps over two trillion dollars today). Unfortunately the surplus is something of a myth. The federal government doesn't put your contributions in a savings bank in anticipation of your retirement. Rather, they've continually used the fund to finance government spending. Baby boomers have reached their peak earnings potential, and their Social Security payments subsidize a much smaller generation born during the 1930s. The first of these boomers are now retired, and the impact of Social Security taxes lost and new benefits being paid spells big problems for the system. There are now almost 3.5 workers paying into the system for each person collecting benefits. Within the next 40 years this ratio will drop to about 2 to 1.<sup>21</sup> Many experts believe this statistic foreshadows the collapse of Social Security as we know it.

### Benefits Under Social Security

The majority of benefits under Social Security fall into four categories: (1) old age or disability benefits, (2) benefits for dependents of retired or disabled workers, (3) benefits for surviving family members of a deceased worker, and (4) lump-sum death payments. To qualify for these benefits, a worker must work in covered employment and earn a specified amount of money (about \$1250 today) for each quarter-year of coverage.<sup>22</sup> Forty quarters of coverage will insure any worker for life. The amount received under the four benefit categories noted above varies, but in general it is tied to the amount contributed during eligibility quarters. For example, a person who had a maximum-taxable earnings in each year since age 22, and who retired this year at age 65 will earn \$2452 per month in benefits.<sup>23</sup>

### Unemployment Insurance

The earliest union efforts to cushion the effects of unemployment for their members (c. 1830s) were part of benevolent programs of self-help. Working members made contributions to their unemployed brethren. With passage of the unemployment insurance law (as part of the Social Security Act of 1935), this floor of security for unemployed workers became less dependent upon the philanthropy of co-workers (147 million workers are covered today). Since unemployment insurance laws vary by state, this review will cover some of the major characteristics of different state programs.

### Financing

In the majority of states, unemployment compensation paid out to eligible workers is financed exclusively by employers that pay federal and state unemployment insurance tax. The federal tax amounts to 6.2 percent of the first \$7,000 earned by each worker.<sup>24</sup> In addition, states impose a tax above the \$7,000 figure. The extra amount a company pays depends on its **experience rating**—lower percentages are charged to employers who have terminated fewer employees. The tax rate may fall to almost 0 percent in some states for employers that have had no recent experience (hence the term "experience rating") with downsizing and may rise to 10 percent for organizations with large numbers of layoffs.

### Coverage

All workers except a few agricultural and domestic workers are currently covered by unemployment insurance (UI) laws. These covered workers (97% of the workforce), though, must still meet eligibility requirements to receive benefits:

1. You must meet the state requirements for wages earned or time worked during an established (one year) period of time referred to as a "base period." [In most states, this is usually the first four out of the last five completed calendar quarters prior to the time that your claim is filed.]
2. You must be determined to be unemployed through no fault of your own [determined under state law], and meet other eligibility requirements of state law.<sup>25</sup>

### Duration

Until 1958, the maximum number of weeks any claimant could collect UI was 26 weeks. However, the 1958 and 1960–61 recessions yielded large numbers of claimants who exhausted their benefits, leading many states temporarily to revise upward the maximum benefit duration. In 2008 Congress enacted the Emergency Unemployment Compensation program (EUC08). The program provided additional weeks of benefits to long term unemployed, extending benefits to as long as 53 weeks.<sup>26</sup>

This program expired in 2013 and maximum benefits duration returned to 26 weeks. Because unemployment has fallen to under 6 percent in many states, there has been some state legislation to reduce duration to as low as 20 weeks.<sup>27</sup>

### Weekly Benefit Amount

In general, benefits are based on a percentage of an individual's earnings over a recent 52-week period—up to the state maximum amount.<sup>28</sup> For example, in many states, the compensation will be half your earnings, up to a maximum amount. For example, New York State recently increased its minimum benefit rate to \$100 and the maximum to \$420 with provisions for annual increases in these figures.<sup>29</sup>

### Controlling Unemployment Taxes

Every unemployed worker's **unemployment benefits** are "charged" against the firm or firms most recently employing that currently unemployed worker. The more money paid out on behalf of a firm, the higher is the unemployment insurance rate for that firm. Efforts to control these costs quite logically should begin with a well-designed **human resource planning system**. Realistic estimates of human resource needs will reduce the pattern of hasty hiring followed by morale-breaking terminations. Additionally, a benefit administrator should attempt to audit pre-layoff behavior (e.g., lateness, gross misconduct, absenteeism, illness, leaves of absence) and compliance with UI requirements after termination (e.g., job refusals can disqualify an unemployed worker). The government can also play an important part in reducing unemployment expenses by decreasing the number of weeks that people are unemployed. Research shows that unemployment duration decreases by three weeks simply by stepping up enforcement of sanctions against fraudulent claims.<sup>30</sup>

### Family and Medical Leave Act (FMLA)

The 1993 **Family and Medical Leave Act** applies to all employers having 50 or more employees and entitles all eligible employees to receive unpaid leave up to 12 weeks per year for specified family or medical reasons.<sup>31</sup> Common reasons for leave under FMLA include caring for a newborn or seriously ill spouse, child, or parent.<sup>32</sup> More state legislatures are now moving toward some form of paid family and medical leave for workers.

### Consolidated Omnibus Budget Reconciliation Act (COBRA)

In 1983 Congress enacted this law to provide current and former employees and their spouses and dependents with a temporary extension of group health insurance when coverage is lost due to qualifying events (e.g., layoffs). All employers with 20 or more employees must comply with COBRA. An employer may charge individuals up to 102 percent of the premium for coverage (100% premium plus 2% administration fee), which can extend up to 36 months (standard 18 months), depending on the category of the qualifying event.<sup>33</sup> The biggest concern for individuals getting health insurance under COBRA is the relatively brief qualifying period. After 18 months you're not eligible. With passage of the Affordable Care Act COBRA participants can opt into the Health Insurance Marketplace discussed in a later section.<sup>34</sup>

### Health Insurance Portability and Accountability Act (HIPAA)

The 1996 HIPAA is designed to (1) lessen an employer's ability to deny coverage for a preexisting condition and (2) prohibit discrimination on the basis of health-related status.<sup>35</sup> Perhaps the most significant element of HIPAA began in 2002, when stringent new privacy provisions added considerable compliance problems for both the HR people charged with enforcement and the information technology people delegated the task of building secure health information systems. Just watch next time you visit a new doctor. You will have to sign a HIPAA document that, should you choose to read it, will make your eyes glaze over.

## RETIREMENT AND SAVINGS PLAN PAYMENTS

Pensions have been around for a long, long time. The first plan was established in 1759 to protect widows and children of Presbyterian ministers. After decades of steady growth in private pension plan coverage, today only 68 percent of workers have access to pension coverage, and only 53 percent actually participate.<sup>36</sup>

Blame competitive pressures from globalization, the recession, and paltry growth in productivity, but the reality is that more than half of the population will depend on Social Security for retirement income. That represents a problem because employees tend to rank pensions as one of the more important benefits.<sup>37</sup> Let's face it, baby boomers are a huge part of the working population now. The first baby boomer turned 66 on January 1, 2012. Every day for the next two decades another 10,000 will be applying for Social Security and dreaming about what they will do in retirement.<sup>38</sup> Pensions play a big role in this dream. The importance of employer-provided retirement plans is evidenced by a study showing that employees with employer-provided retirement plans are more likely to have sufficient savings for a comfortable retirement than those who do not have these plans.<sup>39</sup> Two generic types of pension plans are discussed below: **defined benefit plans** and **defined contribution plans**. As you read their

descriptions, keep in mind that defined benefit plans may be a dying breed.<sup>40</sup> Prominent companies such as IBM, Verizon, and Sears have frozen their traditional defined benefit pension payouts. Workers still get their pensions, but there isn't any growth in the amount as a function of additional time on the job. Rather, many companies are shifting to 401(k) plans (a popular type of defined contribution plan) where the dollar contribution is known and controllable.<sup>41</sup> Today 92 percent of private sector employers with pension plans offer defined contribution plans, compared to only 21 percent offering defined benefit plans.<sup>42</sup> To understand why this rapid change is occurring, we have to explain the cost saving distinctions between the two types of plans.

### Defined Benefit Plans

In a defined benefit plan an employer agrees to provide a specific level of retirement pension, which is expressed as either a fixed dollar or a percentage-of-earnings amount that may vary (increase) with years of seniority in the company. The firm finances this obligation by following an actuarially determined benefit formula and making current payments that will yield the future pension benefit for a retiring employee.<sup>43</sup>

The majority of defined benefit plans calculate average earnings over the last 3 to 5 years of service for a prospective retiree and offer a pension that is about one-half this amount (varying from 30% to 80% percent) adjusted for years of seniority.

So what is it about defined benefit (DB) plans that make them prime targets for cost cutting? The major complaints by chief financial officers (CFOs) center on funding. If I've got to pay Jim \$40,000 a year at retirement, I have to start investing now to have that cash available. How much should I invest though? Given how volatile the stock market is, it's hard to predict how much is needed. CFOs report this is a drag on corporate financial health and a distraction from running the core business. As an example, GM recently eliminated its defined benefit plan for salaried employees. New hires already were covered by a defined contribution (DC) plan. Now all salaried employees are enrolled in DC pension plans. Why? GM has an \$12 billion shortfall in funding its pension. As one step to eliminate their pension burden, GM paid Prudential \$2.5 billion dollars to takeover 25 percent of GM's pension burden.<sup>44</sup> What companies do is purchase annuities with insurance companies. GM has a total of 25 billion in annuities with Prudential. Verizon has a 7.5 billion dollar annuity, also with Prudential. Motorola and Bristol Meyers Squibb paid a combined 4.5 billion to Prudential to takeover all pension payments. These companies buy the annuity at a premium (often 10%). When interest rates fluctuate in the future, now these companies won't have to worry about significantly higher pension costs, the annuity stabilized the cost of their pension obligation.<sup>45</sup>

### Defined Contribution Plans

In a defined contribution (DC) plan the employer makes provisions for contributions to an account set up for each participating employee. Years later when employees retire, the pension is based on their contributions, employer contributions, and any gains (or losses) in stock investments. There are three popular forms of defined contribution plans: A **401(k) plan**, so named for the section of the Internal Revenue Code describing the requirements, is a savings plan in which employees are allowed to defer pretax income. Employers typically match employee savings at a rate of 50 cents on the dollar.<sup>46</sup> Defined contribution plans are more popular than defined benefit plans in both

small and large companies. Expect this disparity to only grow with time! The number of traditional plans continues to drop at a rapid rate.<sup>47</sup> Interestingly, for younger employees this shift may be one of those rare win-win situations. Historically these plans are faster to vest (the companies matched share of the contribution permanently shifts over to employee ownership, and they are more portable—job hopping employees can take their pension accruals along to the next job). On the negative side, the recession of 2008–2010 destroyed many 401(k) portfolios. Poor investment decisions, either by employees or by a chosen financial advisor, reduced many retirement funds by half or more. Further, these plans have been plagued by low contribution rates. About 40 percent of all employees don't contribute enough to get the full employer match.<sup>48</sup> The end result of all this is predictable. About two-thirds of Americans ages 45–60 say they plan to delay retirement, up from 42 percent just two years earlier.<sup>49</sup>

The second type of plan is an **employee stock ownership plan (ESOP)**. In a basic ESOP a company makes a tax-deductible contribution of stock shares or cash to a trust. The trust then allocates company stock (or stock bought with cash contributions) to participating employee accounts. The amount allocated is based on employee earnings. When an ESOP is used as a pension vehicle (as opposed to an incentive program), the employees receive cash at retirement based upon the stock value at that time. ESOPs have one major disadvantage, which limits their utility for pension accumulations. Many employees are reluctant to "bet" most of their future retirement income on just one investment source. If the company's stock takes a downturn, the result can be catastrophic for employees approaching retirement age. A classic example of this comes from Enron . . . yes, the same Enron linked to all the ethics problems. Under Enron's 401(k), employees could elect to defer a portion of their salaries. The employees were given 19 different investment choices, one of which was Enron common stock. Enron matched contributions, up to 6 percent of an employee's compensation. Enron's contributions were made in Enron stock and had to be held until the employee was at least age 50. This feature resulted in 60 percent of the total plan value being in Enron stock in 2001. Guess what? When Enron's shares went through the floor in 2001–2002, thousands of employees saw their retirement nest eggs destroyed. Recently 401(k) contributions have shifted away from company stock. The majority (53%) of companies allow less than 10 percent of assets in company stock.<sup>50</sup>

Finally, a **profit-sharing plan** can be considered a defined contribution pension plan if the distribution of profits is delayed until retirement. Chapter 10 explains the basics of profit sharing.

Not surprisingly, both DB and DC compensation plans are subject to stringent tax laws. For **deferred compensation** to be exempt from current taxation, specific requirements must be met. To qualify, an employer cannot freely choose who will participate in the plan (hence it is labeled a "**qualified deferred compensation plan**"). This requirement eliminated the common practice of building tax-friendly, extravagant pension packages for executives and other highly compensated employees. The major advantage of a qualified plan is that the employer receives an income tax deduction for contributions made to the plan even though employees may not yet have received any benefits. The disadvantage arises in recruitment of high-talent executives. A plan will not qualify for tax exemptions if an employer pays high levels of deferred compensation to entice executives to the firm unless proportionate contributions also are made to lower-level employees.

A hybrid of defined benefit and defined contribution plans has emerged in recent years. **Cash balance plans** are defined benefit plans that look like a defined contribution plan. Employees have a hypothetical account (like a 401(k)) into which is deposited what is typically a percentage of annual compensation. The dollar amount grows both from contributions by the employer and from some predetermined interest rate (e.g., often set equal to the rate given on 30-year treasury certificates).

In 2009, 401(k) contributions were suspended by many companies in the wake of the suffering U.S. economy. General Motors, FedEx, Sears Holdings, and Eastman Kodak are among companies who suspended contributions. One ancillary problem from all these suspensions of pension plans—less money is going into the Pension Benefit Guaranty Corporation (the PBGC charges companies with pensions \$49 dollars per person per year). That means less money to cover future bankruptcies and pension deficits. The PBGC already is running a 27 billion dollar deficit. The numbers are likely to get larger.<sup>51</sup>

### Individual Retirement Accounts (IRAs)

An **individual retirement account (IRA)** is a tax-favored retirement savings plan that individuals can establish themselves. That's right, unlike the other pension options, IRAs don't require an employer to set them up. Even people not in the workforce can establish an IRA. Currently, IRAs are used mostly to store wealth accumulated in other retirement vehicles, rather than as a way to build new wealth.<sup>52</sup>

### Employee Retirement Income Security Act (ERISA)

The early 1970s were a public relations and economic disaster for private pension plans. Many people who thought they were covered were the victims of complicated rules, insufficient funding, irresponsible financial management, and employer bankruptcies. Some pension funds, including both employer-managed and union-managed funds, were mismanaged; other pension plans required long vesting periods. The result was a pension system that left far too many lifelong workers poverty stricken. Enter the Employee Retirement Income Security Act in 1974 as a response to these problems.

ERISA does not require that employers offer a pension plan. But if a company decides to have one, it is rigidly controlled by ERISA provisions.<sup>53</sup> These provisions were designed to achieve two goals: (1) to protect the interest of approximately 100 million active participants,<sup>54</sup> and (2) to stimulate the growth of such plans. The actual success of ERISA in achieving these goals has been mixed at best. In the first two full years of operation (1975 and 1976) more than 13,000 pension plans were terminated. A major factor in these terminations, along with the recession, was ERISA. Employers complained about the excessive costs and paperwork of living under ERISA. Some disgruntled employers even claimed ERISA was an acronym for "Every Ridiculous Idea Since Adam." To examine the merits of these claims, let us take a closer look at the major requirements of ERISA.

### General Requirements

ERISA requires that employees be eligible for pension plans beginning at age 21. Employers may require 12 months of service as a precondition for participation. The service requirement may be extended to three years if the pension plan offers full and immediate vesting.

### Vesting and Portability

These two concepts are sometimes confused but have very different meanings in practice. **Vesting** refers to the length of time an employee must work for an employer before he or she is entitled to employer payments made into the pension plan. The vesting concept has two components. First, any contributions made by the employee to a pension fund are immediately and irrevocably vested. The vesting right becomes questionable only with respect to the employer's contributions. The Economic Growth and Tax Relief Reconciliation Act of 2001 states that the employer's contribution must vest at least as quickly as one of the following two formulas: (1) full vesting after three years (down from five years previously) or (2) 20 percent after two years (down from three years) and 20 percent each year thereafter, resulting in full vesting after six years (down from seven years).

The vesting schedule an employer uses is often a function of the demographic makeup of the workforce. An employer who experiences high turnover may wish to use the three-year service schedule. By so doing, any employee with less than three years' service at time of termination receives no vested benefits. Or the employer may use the second schedule in the hopes that earlier benefit accrual will reduce undesired turnover. The strategy adopted is, therefore, dependent on organizational goals and workforce characteristics. **Portability** of pension benefits becomes an issue for employees moving to new organizations. Should pension assets accompany the transferring employee in some fashion? ERISA does not require mandatory portability of private pensions. On a voluntary basis, though, the employer may agree to let an employee's pension benefits transfer to the new employer. For an employer to permit portability, of course, the pension rights must be vested.

### Pension Benefit Guaranty Corporation

Despite the wealth of constraints imposed by ERISA, the potential still exists for an organization to go bankrupt or in some way fail to meet its vested pension obligations. We guarantee you, there are many Eastman Kodak employees who lose sleep over this issue! To protect individuals confronted by this problem, employers are required to pay insurance premiums to the **Pension Benefit Guaranty Corporation (PBGC)** established by ERISA. In turn, the PBGC guarantees payment of vested benefits to employees formerly covered by terminated pension plans. Over 40 million people depend on the PBGC to protect 1.5 trillion dollars in pension benefits. In 2008 the PBGC had deficits of 11.2 billion dollars.<sup>56</sup> Today that deficit is 27 billion.<sup>57</sup>

### Pension Protection Act of 2006 (PPA)

You remember Enron? Maybe you didn't know that many Enron employees lost more than their jobs. As we noted earlier, many employees had pension funds allocated to Enron stock. When the stock went through the floor, so did many retirement dreams. The PPA was passed by Congress in the wake of Enron and WorldCom. Its purpose was to protect employees' retirement income as well as transfer some responsibility for retirement savings from the employer to the employee. A key provision of the law allows employees in publicly traded companies the freedom to sell off any employer stock purchased through deferrals or after-tax contributions. We expect this provision will motivate employees toward investing in defined contribution plans and reduce some of the burden on employers. The law also aims at employers who fail to set aside enough reserves to cover current and future pension obligations by defining plans less than 70% funded as 'at risk' plans.

## How Much Retirement Income to Provide?

The level of pension a company chooses to offer depends on the answers to five questions. First, what level of retirement compensation would a company like to set as a target, expressed in relation to pre-retirement earnings? Second, should Social Security payments be factored in when considering the level of income an employee should have during retirement? One integration approach reduces normal benefits by a percentage (usually 50%) of Social Security benefits.<sup>58</sup> Another feature employs a more liberal benefit formula on earnings that exceed the maximum income taxed by Social Security. Regardless of the formula used, about one-half of U.S. companies do not employ the cost-cutting strategy. Once a company has targeted the level of income it wants to provide employees in retirement, it makes sense to design a system that integrates private pension and social security to achieve that goal. Any other strategy is not cost-effective.

Third, should other postretirement income sources (e.g., savings plans that are partially funded by employer contributions) be integrated with the pension payment? Fourth, a company must decide how to factor seniority into the payout formula. The larger the role played by seniority, the more important pensions will be in retaining employees. Most companies believe that the maximum pension payout for a particular level of earnings should be achieved only by employees who have spent an entire career with the company (e.g., 30 to 35 years). As Exhibit 13.7 vividly illustrates, job hoppers are hurt financially by this type of strategy. In our example—a very plausible scenario—job hopping cuts final pension amounts in half.

Finally, companies must decide what they can afford. In recent years the press has printed dozens of stories about companies having a hard time funding their pension plans. Similar problems are on the public sector horizon. Between 2000 and 2004 average state and local benefit amounts grew 37 percent to \$19,875. States also are allowing their employees to retire younger, often as early as 55. Estimates suggest

**EXHIBIT 13.7** The High Cost of Job Hopping\*

| Career History       | Years in Company | Percent of Salary for Pension | Salary at Company (Final) | Annual Pension  |
|----------------------|------------------|-------------------------------|---------------------------|-----------------|
| <b>Sam</b>           |                  |                               |                           |                 |
| Job 1                | 10               | 10%                           | \$ 35,817                 | = \$ 3,582      |
| Job 2                | 10               | 10%                           | \$ 64,143                 | = 6,414         |
| Job 3                | 10               | 10%                           | \$114,870                 | = 11,487        |
| Job 4                | 10               | 10%                           | \$205,714                 | = 20,571        |
| <b>Total pension</b> |                  |                               |                           | <b>\$42,054</b> |
| <b>Ann</b>           |                  |                               |                           |                 |
| Job 1                | 40               | X                             | \$205,714                 | = \$82,286      |
| <b>Total pension</b> |                  |                               |                           | <b>\$82,286</b> |

Source: Federal Reserve Bank of Boston.

\*Assumptions: (1) Starting salary of \$20,000 with 6 percent annual inflation rate; (2) Both employees receive annual increases equal to inflation rate. (3) Pensions based on 1 percentage point (of salary) for each year of service multiplied by final salary at time of exit from company.

federal, state, and local governments are underfunding pensions by somewhere between .7 and 2.5 trillion dollars.<sup>59</sup> Don't count on your taxes being cut any time soon!

## LIFE INSURANCE

Roughly three-fourths of all employees have access to paid life insurance, and this figure is about the same in both the private and public sectors.<sup>60</sup> Typical coverage would be a group term insurance policy with a face value of one to two times the employee's annual salary.<sup>61</sup> Most plan premiums are paid completely by the employer.<sup>62</sup> The cost is about ten cents per hour per employee.<sup>63</sup> Slightly over 30 percent include retiree coverage. To discourage turnover, almost all companies make this benefit forfeitable at the time of departure from the company.

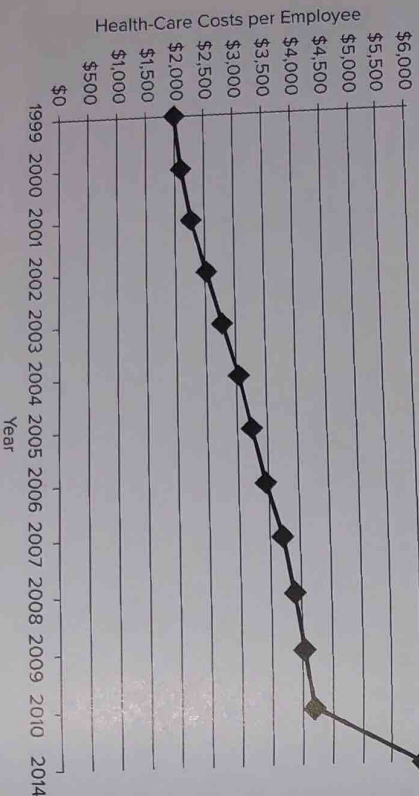
Life insurance is one of the benefits heavily affected by movement to a flexible benefit program. Flexibility is introduced by providing a core of basic life coverage (e.g., \$25,000). The option then exists to choose greater coverage (usually in increments of \$10,000 to \$25,000) as part of the optional package.

## MEDICAL AND MEDICALLY RELATED PAYMENTS

### General Health Care

Health-care costs continue to increase. Exhibit 13.8 shows the dollar increase over time. More costly technology, the explosion of lawsuits, the increased number of elderly people, and a system that does not encourage cost savings have all contributed to

**EXHIBIT 13.8** Health-Care Costs per Employee 1999–2014  
Health-Care Costs per Employee



Source: U.S. Department of Labor, Bureau of Labor Statistics, [www.bls.gov](http://www.bls.gov); Kaiser Family Foundation 2014 Employer Health Benefits 2014 annual survey.

the rapidly rising costs of medical insurance. In the past 15 years, though, employers have battled these rises. Despite these efforts, companies like GM figure about \$1,500 toward the price of every car they manufacture comes from health-care costs. Comparatively, steel in the same cars costs less! Is it any wonder that companies across the country are seeking ways to cut healthcare costs or eliminate them completely from their benefits package. After a discussion of the types of health-care systems, these cost-cutting strategies will be discussed.

Before 1930 health care coverage essentially didn't exist. Health issues were the responsibility of the family. After the Great Depression, though, Blue Cross (BC) and Blue Shield (BS) appeared as the first institutional health care. Envious of the profits made by BC/BS, insurance companies began to offer plans for hospitalization along with doctor and surgical coverage. Then, of course, the government got involved. In the 1960s national health insurance emerged to cover the elderly (Medicare) and the poor (Medicaid). Then in 2012 the Affordable Care Act (ACA aka Obamacare) was instituted to target the uninsured with a goal of providing health care coverage to everyone. This controversial act isn't intended to change the way health care is delivered, but rather to provide both positive and negative incentives to make sure everyone is covered. Exhibit 13.9 outlines the ACA in 200 words or less. Here goes:

Some of the most dire predictions of "Obamacare" haven't occurred. First, it was predicted that large premium increases to employers would cause employers to decrease employment. Insurance premiums in the first full year of the plan rose only 3 percent, the lowest increase in 16 years.<sup>65</sup> It also was feared that many individuals would face the noncompliance fine. Actually, fewer than 10 percent

**EXHIBIT 13.9** The Affordable Care Act in 200 Words or Less

1. If you have health coverage and it makes you smile, keep it.
2. If you don't have coverage you can use the new Health Insurance Marketplace to buy a private plan (like Blue Cross/Blue Shield or an HMO).
3. If you qualify (family size and income) you may get lower costs on premiums and out of pocket medical expenses.
4. You may also qualify for free or low cost coverage under Medicaid or Children's Health Insurance Program.
5. If you have coverage already and want to consider changing based on looking at Marketplace plans, you can. If, however, you have an offer of insurance from your employer, you may not be able to get lower costs based on your income. It depends on whether the employer coverage is considered affordable (costs less than 9.5% of an employee's household income) and meets minimum standards (covers more than 60% of plan cost).
6. A large employer who doesn't offer health care coverage for all full-time employees is taxed  $\$2,000 \times N - 30$  ( $N$  = number employees) per year.
7. Individuals must purchase a plan either through their employer, through private companies or through state-mandated insurance programs. Failure to do so results in a 2016 tax of \$695 per adult (half that for children) up to a family maximum of \$2,085 (or 2.5% of family income, whichever is greater).
8. Any company with too good a plan (more than \$10,200 individual or \$27,500 family cost) pays a 40 percent "Cadillac tax" so named because the big three automakers are prime targets.<sup>66</sup>

of uninsured are likely to be fined, largely because the Obama administration has increased the number of exemptions permitted (e.g., exempt if electricity has been cut off for non payment).

The Affordable Care Act hasn't changed the basic underlying structure of health care delivery. The first method is through commercial insurance companies like Prudential, Aetna and Humana. Plans through these companies are called indemnity plans or so-called pay for service plans. Under these plans an employee can choose any health care provider. The second method of delivery is through a Health Maintenance Organization (HMO). An HMO pulls together a group of providers (e.g., hospitals and doctors) willing to provide services at an agreed upon rate in exchange for the employer limiting employees to these providers for health services. Employees make prepayments in exchange for guaranteed health care services on demand. Third, to provide employees with more options in selecting doctors and hospitals, Preferred Provider Organizations (PPOs) arose. Employers select certain providers who agree to provide price discounts and submit to strict utilization controls (e.g., strict standards on number of diagnostic tests that can be ordered). In turn, the employer influences employees to use these providers by charging higher fees if employees make selections outside the provider network. Finally, a **point-of-service plan (POS)** is a hybrid plan combining HMO and PPO benefits. The POS plan permits an individual to choose which plan to seek treatment from at the time that services are needed. POS plans, therefore, provide the economic benefits of the HMO with the freedom of the PPO. The HMO component of the POS plan requires office visits to an assigned primary care physician, with the alternative of receiving treatment through the PPO component. The PPO component does not require the individual to first contact the primary care physician but does require that in-network physicians be used. When POS plan participants receive all of their care from physicians in the network, they are fully covered, as they would be under a traditional HMO. Point-of-service plans also allow individuals to see a doctor outside the network, for which payment of an annual deductible ranging between \$100 and \$5,000 is required.<sup>64</sup>

Costs and participation rates of each type of plan are noted in Exhibit 13.10.

|                                | Premium Paid |             |
|--------------------------------|--------------|-------------|
|                                | By Employee  | By Employer |
| HMO                            | 1182         | 5041        |
| PPO                            | 1134         | 5082        |
| POS                            | 984          | 5182        |
| <b>Enrollment by Plan Type</b> |              |             |
| PPO                            | 58%          |             |
| HMO                            | 13           |             |
| POS                            | 8            |             |
| Conventional (indemnity) < 1   |              |             |

## Health Care: Cost Control Strategies

There are three general strategies available to benefit managers for controlling the rapidly escalating costs of health care.<sup>67</sup> First, organizations can motivate employees to change their demand for health care, through changes in either the design or the administration of health insurance policies. Included in this category of control strategies are (1) deductibles, or the first x dollars of health-care cost are paid by the employee (at the extreme the state of Georgia recently told employees that certain name brand drugs will require a \$100 copay, clearly signaling that enough is enough<sup>68</sup>); (2) coinsurance rates (premium payments are shared by the company and employee); (3) maximum benefits (defining a maximum payout schedule for specific health problems); (4) coordination of and a spouse's plan); (5) auditing of hospital charges for accuracy; (6) requiring preauthorization for selected visits to health-care facilities; (7) mandatory second opinion whenever surgery is recommended; (8) using intranet technology to allow employees access to online benefit information, saving some of the cost of benefit specialists<sup>69</sup>; (9) providing incentives to employees for using providers who meet certain high performance criteria.<sup>70</sup> The more questions answered online, the fewer specialists needed.

The second general cost control strategy involves changing the structure of health-care delivery systems and participating in business coalitions (for data collection and dissemination). At the extreme are companies that simply decline to provide any health-care coverage whatsoever.

Less extreme are choices like HMOs, PPOs, POSs, and consumer-directed health-care plans. Also called Consumer-Driven Health Plans and High Deductible Plans, this increasingly popular option for companies cuts costs by shifting much of the burden of purchasing health care over to employees. Employees choose from any of the traditional providers (HMO, PPO, Indemnity Plans), but the employer sets its contribution equal to the lower cost of these three (usually HMO). If the employee wants a more expensive option, the extra cost is out-of-pocket. These plans usually are accompanied by high deductibles, sometimes reaching several thousand dollars.<sup>71</sup> Typically an employer helps lessen the cost of the deductible by setting up Health Savings (HSA) or Health Reimbursement (HRA) accounts. Funds in these accounts are either contributed by employees with pre-tax dollars (HSA) or by the employer up to some fixed dollar amount (HRA). All of this complexity is introduced simply to force employees to make choices in the most economical way while hopefully not neglecting important health issues.

A final category of cost control strategies links incentives to healthy behaviors. We know that preventable illnesses account for 70 percent of all health-care costs.<sup>72</sup> Obesity, for example, is preventable. Dieting, however, is not a favorite pastime. How, then, do we get people to lose weight? The answer may be health incentives. For example, Caesar's Casinos give a 40 dollar award to employees who get screened to measure cholesterol level and then work (e.g., lose weight) to lower levels. More than two-thirds of medium and large employers with wellness programs have incentives to get employees involved in wellness.<sup>73</sup> JetBlue provides a maximum of \$400 in Health Reimbursement Accounts to be used by employees in roughly 45 activities (e.g.,

smoking cessation). On the negative incentive side, CVS drugstores charge employees \$600 more in health premiums for not completing wellness assessment activities like annual checkups. In general, incentives are becoming much more popular. In 2009 only 57 percent of companies had any of these incentive. Now 75 percent use these motivational tools.<sup>74</sup>

**e-Compensation**  
The Health Insurance Association of America provides research about a wide variety of specific health-related issues at its website, [www.ahip.org/](http://www.ahip.org/)

### Short- and Long-Term Disability

A number of benefit options provide some form of protection for disability. For example, workers' compensation covers disabilities that are work-related. Even Social Security has provisions for disability income to those who qualify. Beyond these two legally required sources, there are two private sources of disability income: employee **salary continuation plans** and **long-term disability plans**.<sup>75</sup>

Many companies have some form of salary continuation plan (we include here vacation days that might be used for sick leave as a last resort) that pays out varying levels of income depending on duration of illness (see Exhibit 13.11).

At one extreme is short-term illness covered by sick leave policy and typically reimbursed at a level equal to 100 percent of salary.<sup>76</sup> The most prevalent practice these days is to give paid time off (PTO) rather than sick days. This reduces the need for companies to "police" whether employees are indeed sick, and allows employees more flexibility in life planning. After such benefits run out, disability benefits become operative. **Short-term disability (STD)** pays a percentage of your salary (about 60% on average) for temporary disability because of sickness or injury (on-the-job injuries are covered by workers' compensation). Only about 37 percent of all employers provide this insurance after sick leave.<sup>77</sup> **Long-term disability plans (LTD)**, if available, typically kick in after the short-term plan expires. Long-term disability is usually underwritten by insurance firms and provides 60 to 70 percent of pre-disability pay for a period varying between two years and life.<sup>78</sup> Estimates

**EXHIBIT 13.11** Access to Leave Programs

| Percent of Workers in Private Industry/State Local Government with Access to Different Leave Programs |                    |                          |
|-------------------------------------------------------------------------------------------------------|--------------------|--------------------------|
| Type of Leave                                                                                         | Private Industry % | State/Local Government % |
| Paid Sick Leave                                                                                       | 61                 | 80                       |
| Paid Vacation                                                                                         | 77                 | 59                       |
| Short Term Disability                                                                                 | All workers 37     |                          |
| Long Term Disability                                                                                  | All workers 34     |                          |

Source: National Compensation Survey, 2014. <http://www.bls.gov/news.release/benef12014feb00055.pdf>.

indicate that only about 34 percent of all U.S. businesses provide long-term disability insurance.<sup>79</sup>

### Dental Insurance

A rarity 30 years ago, dental insurance is now much more prevalent, with about 60 percent of all employers with more than 500 employees providing some level of health-care plans. The dental equivalent of HMOs and PPOs is the standard delivery system. For example, a dental HMO enlists a group of dentists who agree to treat company employees in return for a fixed monthly fee per employee.

At the start of the century, the typical cost for employee dental coverage was \$219.<sup>81</sup> Annual cost increases now, though, are beginning to heat up. Employers battle these increases by requiring employee contributions—94 percent of employers require cost sharing now.<sup>82</sup> The relatively modest increase in dental care costs can be traced to stringent cost control strategies (e.g., plan maximum payouts are typically \$1,000 or less per year) and an excess supply of dentists. As the excess turns into a predicted shortage in the coming years, we may expect dental benefit costs to grow at a faster rate.<sup>83</sup>

### Vision Care

Vision care dates back only to the 1976 contract between the United States Auto Workers and the Big Three automakers. Since then, this benefit has spread to other auto-related industries and parts of the public sector. Seventy-eight percent of large employers offer a vision plan.<sup>84</sup> Most plans are noncontributory and usually cover partial costs of eye examination, lenses, and frames.

## MISCELLANEOUS BENEFITS

### Paid Time Off During Working Hours

Paid rest periods, lunch periods, wash-up time, travel time, clothes-change time, and get-ready time benefits are self-explanatory.

### Payment for Time Not Worked

Included within this category are several self-explanatory benefits:

1. Paid vacations and payments in lieu of vacation
2. Payments for holidays not worked
3. Paid sick leave
4. Other (payments for National Guard, Army, or other reserve duty; jury duty and voting pay allowances; payments for time lost due to death in the family or other personal reasons).

Exhibit 13.12 shows what you can look forward to for vacations after you graduate. Stay in school!

Twenty years ago it was relatively rare to grant time off for anything but vacations, holidays, and sick leave. Now many organizations have a policy of ensuring payments

EXHIBIT 13.12 Employees Receiving Leave Time Benefits

| Employee Benefits Paid Time Off | All Full-Time Employees | Professional, Technical, and Related Employees | Office and Administrative Employees | Blue Collar / Construction Employees |
|---------------------------------|-------------------------|------------------------------------------------|-------------------------------------|--------------------------------------|
| Holidays                        | 75%                     | 89%                                            | 79%                                 | 83%                                  |
| Vacation                        | 77                      | 88                                             | 68                                  | 81                                   |

Source: Employee Benefits Survey, <http://www.bls.gov/news.release/ebs2.t06.htm>, issued April 29, 2015.

for civic responsibilities and other obligations. Any outside pay for such civic duties (e.g., jury duty) is usually nominal, so companies often supplement this pay, frequently to the level of 100 percent of wages lost. There is also increasing coverage for parental leaves. Maternity and, to a lesser extent, paternity leaves are much more common than they were 25 years ago. Indeed, passage of the Family and Medical Leave Act in 1993 provides up to 12 weeks of unpaid leave (with guaranteed job protection) for the birth or adoption of a child or for the care of a family member with a serious illness. The following sick policy, taken from Motley Fool's employee manual, shows just how far such policies have come:

Unlike other companies, The Motley Fool doesn't make you wait for six months before accruing vacation or sick time. Heck, if you're infected with some disgusting virus—stay home! We like you, but don't really want to share in your personal anguish. In other words, if you're bleeding out your eyes and coughing up a lung—don't be a hero! Stay home. Out of simple Foolish courtesy, we expect you to call your supervisor and let him or her know you won't be in. And yes, you will get paid. So, pop quiz: You're feeling like you're going to snap any moment if you don't take some personal time off, you've made a small deposit on an M-16 rifle and are scoping out local clock towers. BUT you've only been a paid Fool for a short time . . . what do you do, what do you do?<sup>85</sup>

Many companies are switching from **traditional time-off plans (TTO)**, as described above, to **paid-time-off (PTO) plans**. These lump all time off together into one total allotment and deduct any day missed from this bank. Not only is this administratively easier for companies to track, but it also eliminates the need for employees to lie and say they're sick when the reality is, for example, a scheduled dentist appointment.<sup>86</sup>

### Child Care

Relatively few companies directly provide child care. However, it's becoming quite common for employers (96%) to offer flexible spending accounts with child care expenditures as a legitimate expense.<sup>87</sup> The employee, employer, or both pay into an account with pre-tax monies, and individuals can then use these funds to pay local child care providers.

### Elder Care

With longer life expectancy than ever before and the aging of the baby-boom generation, one benefit that will become increasingly important is elder care assistance. Almost one-half of the companies offering child care assistance to employees also offer elder care assistance.<sup>88</sup>

## Domestic Partner Benefits

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Domestic partner benefits are benefits that are voluntarily offered by employers to an employee's unmarried partner, whether of the same or opposite sex. The major reasons motivating U.S. corporations to provide domestic partner benefits include fairness to all employees regardless of their sexual orientation or marital status.

### Legal Insurance

Prior to the 1970s, prepaid legal insurance was practically nonexistent. Even though such coverage was offered only by approximately 7 percent of all employers in 1997, that percentage has more than tripled in the past decade (24%).<sup>89</sup> A majority of plans provide routine legal services (e.g., divorce, real estate matters, wills, traffic violations) but exclude provisions covering felony crimes, largely because of the expense and potential for bad publicity. Keep in mind, though, that most legal insurance premiums are paid by the employee, not the employer. Technically, then, this doesn't qualify as a traditional employee benefit.

## BENEFITS FOR CONTINGENT WORKERS

Depending on what definition we use, **contingent workers** represent between 5 and 35 percent of the workforce. Ninety percent of all employers use some contingent workers.<sup>90</sup> Contingent work relationships include working through a temporary help agency, working for a contract company, working on call, and working as an independent contractor. Both to reduce costs (because benefits are reduced to 50% of what full-time workers receive) and to permit easier expansion and contraction of production/services, contracting offers a viable way to meet rapidly changing environmental conditions.

## Your Turn

### Adapting Benefits to a Changing Strategy

McDonald's is in the news quite a bit these days. As profits fall or fail to meet Wall Street expectations, senior management scrambles for answers to a changing environment: millennials are perceived to prefer products that are healthier; customers complain about long wait times in the drive thru; competitors offer burgers made to order that seem to resonate with today's customers. In response McDonald's has made a number of major changes. It is reducing the size of its menu to reduce the amount of preparation time. On the other hand, they have introduced a new kiosk environment where customers can build their own burger at the cost of a rise in wait time of several minutes. In addition, over the past years McDonald's has worked hard to reduce its turnover. Among other efforts they have moved their average employee age up to the high 20s. They recently announced wage increases and more paid time off for all its corporate owned stores. Given what we've told you here and what you can glean from news reports about McDonald's, what do you think is going on? Specifically, how do corporate strategy and wage/benefit decisions either support or conflict with each other?

## Summary

Since the 1940s, employee benefits have been the most volatile area in the compensation field. From 1940 to 1980, dramatic changes came in the form of more and better types of employee benefits. The result should not have been unexpected. Employee benefits are now a major, and many believe prohibitive, component of doing business. Look for this century to be dominated by cost-saving efforts to improve the competitive position of American industry. A part of these cost savings will come from tighter administrative controls on existing benefit packages. But another part, as already seen in the auto industry, may come from a reduction in existing benefit packages. If this does evolve as a trend, benefit administrators will need to develop a mechanism for identifying employee preferences (in this case "least preferences") and use them as a guideline to meet agreed upon savings targets.

## Review Questions

1. James A. Klingon has a mandate from his boss to cut employee benefit costs. In a company expanding by 10 percent in employees every year, Jim decides to control costs through his selection strategy. Is he crazy? Or crazy like a fox? Explain.
2. Explain the concept of experience rating using examples from unemployment insurance. Would the same concept apply to workers' compensation? Using the Internet, find out if experience rating plays a role in insurance coverage.
3. The CEO of Kinkle Forms Inc. says there is a serious problem with turnover, with data for her observation provided below.

| Seniority | Turnover Rate |
|-----------|---------------|
| 0-2 yrs   | 61%           |
| 2-5 yrs   | 21%           |
| 5+yrs     | 9%            |

The CEO wants to use employee benefits to lessen this problem. Before agreeing to look at this as the solution, what should run through your mind as a trained professional? What might you do, specifically, in the areas of pension vesting, vacation and holiday allocation, and life insurance coverage in the effort to reduce turnover?

4. Why are defined contribution pension plans gaining in popularity in the United States and defined benefit plans losing popularity?
5. Some experts argue that consumer-directed health care is, amongst other things, a great communications tool for employee benefits. Defend this position.

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