Short-Term Disability Plan Design: Effects on Employee Behavior and Outcomes

SHRM 61st Annual Conference & Exposition

Tuesday June 30, 2009 - 4:00 - 5:15 PM
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Presenter

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How do companies reduce costs and absences in their short-term disability programs?
Is plan design on your radar screen?

• Examine predominant plan design features
  > Distinguish which data outcomes are attributable to plan design versus disability management practices
  > Understand intended and unintended effects on employee behavior

• Learn to better compare your results during external benchmarking
Predominant Plan Design Features
Maximum Length of Benefits

• Duration
  > Industry Ranges: 90 days to 52 weeks
  > Typically exhausts at 180 days or 26 weeks

• Effect on Employee Behavior
  > Economic incentives
  > Break of Service Issues

**Tip:** Unless the maximum length of benefits is the same, any duration comparisons between companies will be skewed. For that reason, companies may first want to do internal benchmarking between business units or divisions.
Wage Replacement

• Industry Ranges: 60%-66 2/3%-70%-100%
  > Concurrent with Workers’ Compensation

• Weekly or Monthly Caps or Maximums?

• Different pay structures:
  > Hourly versus Salaried
  > Executive Compensation

• Pre-Tax or After-Tax

• Tiered benefit structures add complexity
  > 100% of pre-disability earnings for the first 14 weeks, 80% thereafter
•“Watershed level” wage replacement is 70 percent
  >Over 70 percent increases lost time, and below 70 percent reduces lost time
  >Noted that a key factor is “the number of individuals with lower wage replacements coming back to work prematurely.”
  >Further, duration averages were at least 20% higher than normal when companies offered 100% income replacement.

• “IRS Revenue Ruling Offers Employers New Design Opportunity for Disability Plans”
  http://benefitslink.com/articles/washbull040614.html

> Employers can give their employees the opportunity to choose each year whether to pay short- and long-term disability premiums on a pre- or after-tax basis without causing the plan to be treated as a contributory plan.

> This is significant because it outlines a way employers can give their employees substantial flexibility to determine whether their short- or long-term disability benefits will be subject to tax.
Pre-Tax versus After-Tax Benefits

• Effect on Employers:
  > Offer greater benefit if After-Tax
  > Caution: Annual Election Process
    • Communication requirements
    • Default administration procedure easiest
    • Adds complexity to open enrollment
Pre-Tax versus After-Tax Benefits

• Effect of Employees:
  > Avoid taxes on disability benefits by paying the premiums themselves with after-tax dollars, or by including the value of employer-paid premiums in income.
  > Would you rather have 60% of your pay taxed when you are on disability or receive your disability pay tax free?
• When do benefits start?
  > Often called waiting period, which is actually the time an employee must wait to be eligible for benefits e.g. 6 months after hire date

• Industry Ranges: From day one of disability to after an elimination period of 3, 7, 14 or 30 days
  > Usually elimination period covered by sick leave or PTO

• Mixed Rules: Day one for hospitalization or accidents and 7 day wait for all others

• Retroactive payment to day one
  • Reinstatement of PTO/Vacation time
  • Significant driver of employee behavior!
Elimination Period

• Best practice is 3-7 days with benefits starting day 4 or day 8 after medical disability
  > Main consideration is concurrency and centralization of FMLA/STD administration

Tips:
  > Early intervention is key to reducing costs and duration of absences.
  > Focus on retroactive payment to day one as an unintended employee behavior consequence!
The Value of Early Claim Notification

The Life of a Claim

- When all claims reported on average within 7 days, there is a 32% shorter standard duration.
- When 75% of claims reported on or after 15 days.

Source: CIGNA Group Insurance, 2001-2002 STD Duration Study
Most Common STD Plan Designs

<table>
<thead>
<tr>
<th>Plan Type</th>
<th>Elimination Period</th>
<th>Max. Benefit Duration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type 1</td>
<td>1 week</td>
<td>24/26 weeks</td>
</tr>
<tr>
<td>Type 2</td>
<td>0/1 days</td>
<td>24/26 weeks</td>
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<tr>
<td>Type 3</td>
<td>1 week</td>
<td>12/13 weeks</td>
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<tr>
<td>Type 4</td>
<td>2 weeks</td>
<td>24/26 weeks</td>
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<tr>
<td>Type 5</td>
<td>0/1 days</td>
<td>12/13 weeks</td>
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<tr>
<td>Type 6</td>
<td>3/5 days</td>
<td>24/26 weeks</td>
</tr>
<tr>
<td>Type 7</td>
<td>1 week</td>
<td>1 year</td>
</tr>
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</table>

• **Industry Best Practices**
  > Align with company’s Return to Work (RTW) policy
  > Avoid regular occupation and material and substantial
  > Use language “any transitional assignment available”

**Tip:** Do not include language that would result in employees being able to refuse a temporary or transitional assignment and continue to receive benefits when the company has identified productive work.
• How do you define what is considered a new claim versus a continuance of a previous claim?

> Period of Disability: how mixed periods of inability/ability to work will be treated for purposes of satisfying a new elimination period or meeting the maximum duration of benefit.
Relapse/Recurrence

- **Industry Ranges: 10-90 days**
  - Many insured plans have standard 14 days
  - Plans with strong RTW focus and productivity outcomes have a cycle of at least 30 days.

**Tip:** If recurrence period is too short, it is more difficult to determine whether the person is able to sustain permanent employment.
Other Considerations

• **Eligibility:** Who is entitled to receive benefits from the plan?
  > Employment Requirements:
    – Only full-time employees
    – Employees working at least 24 hours per week
  > Waiting Period:
    – Benefit eligible from day one of employment
      – After 6 months of employment
      – After 1 year of employment

**Tip:** EMPAQ® standardizes metrics to ensure a comparable rate-adjusted view based on covered employees
Comparing Results during External Benchmarking
What is EMPAQ®?

• **Employer**
• **Measures of**
• **Productivity**
• **Absence and**
• **Quality**
Beyond the name

• A set of standardized metrics and tools to evaluate benefit program performance

• A benchmarking program in partnership with the Health Management Resource Center of the University of Michigan
• Employers use EMPAQ® metrics and tools to:
  > Evaluate internal program performance and participant satisfaction
  > Validate program improvement via external benchmarks
  > Help foster senior management support for their programs
Average Claim Duration - STD

- Your Company
- Industry Sector Median
- Total Participant Median

Calendar Days:
- 49
- 50
- 51
- 52
- 53
- 54
- 55
- 56
- 57
# EMPAQ® Outcome Matrix

<table>
<thead>
<tr>
<th>METRIC CATEGORY</th>
<th>MAXIMUM LENGTH OF BENEFIT</th>
<th>WAGE REPLACEMENT LEVELS</th>
<th>DEFINITION OF DISABILITY</th>
<th>ELIMINATION PERIOD</th>
<th>RELAPSE PERIOD</th>
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</thead>
<tbody>
<tr>
<td>BENEFIT COST</td>
<td>90 days</td>
<td>60 %</td>
<td>Own Occupation</td>
<td>Day 1, Day 7, Day 14, Day 30</td>
<td>14 days</td>
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<tr>
<td></td>
<td>26 weeks/180 days</td>
<td>70 %</td>
<td></td>
<td></td>
<td>30 days</td>
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<td></td>
<td>52 weeks</td>
<td>100%</td>
<td></td>
<td></td>
<td>90 days</td>
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<td></td>
<td></td>
<td></td>
<td>With or Without</td>
<td>Retroactive to 1st day of disability?</td>
<td>(also dependent on relapse rules)</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Transitional Assignment</td>
<td>Yes</td>
<td>Impact Varies</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>No</td>
<td>Impact Varies</td>
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<tr>
<td>DURATION</td>
<td>Longer Max = Longer</td>
<td>Higher % = Higher</td>
<td>With transitional</td>
<td>Longer EP = Higher</td>
<td></td>
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<tr>
<td></td>
<td>Durations</td>
<td>duration</td>
<td>assignment reduces costs</td>
<td>Duration</td>
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<td></td>
<td>Longer EP = Higher</td>
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<td>Duration</td>
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<td>Longer Relapse</td>
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<td>Period = Longer</td>
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<td></td>
<td></td>
<td>Durations</td>
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<tr>
<td>INCIDENCE RATE</td>
<td>No impact</td>
<td>Higher % = Higher</td>
<td>With transitional</td>
<td>Longer EP = Lower</td>
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<tr>
<td></td>
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<td>Incidence</td>
<td>assignment reduces</td>
<td>Incidence</td>
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<td></td>
<td></td>
<td>incidence</td>
<td>Longer EP = Lower</td>
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<td>Incidence</td>
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<td>Longer Relapse</td>
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<td></td>
<td>Period = Lower</td>
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<td></td>
<td></td>
<td>Incidence Rates</td>
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<tr>
<td>LOST WORK DAYS</td>
<td>Longer Max = Higher</td>
<td>Higher % = Higher</td>
<td>With transitional</td>
<td>Impact Varies</td>
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<tr>
<td></td>
<td>Lost Work Days</td>
<td>Lost</td>
<td>assignment reduces</td>
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<td>Impact Varies</td>
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For more information, please visit:  www.empaq.org
Plan Design Case Studies
Case Study

• Actual employer example of 2005 to 2006 data trends
• Incidence rates went up
• Durations went up
• Cost per EE went down dramatically
• They did NOT reduce the benefit rate or caps, or change any of the payment structures
• Payroll/Salary Mix: went up 4% COLA
What happened?

• Minor change in plan design—elimination period
• 2005: Standard 7 day elimination with mixed rules for hospitalization and accident; paid from day one
• 2006: Removed day one pay for hospitalization and accident and moved to global 7 day elimination period (except for one group)
  > To reduce administrative complexities/payroll errors
  > To reduce employees incentives for inpatient vs. outpatient procedures and claiming injuries were accident related
The results may surprise you

- **2005:** 1508 claims with first 7 days paid
  - $1508 \times 7 = 10,556 \text{ paid days}$
  - Paid day = $74.52$
  - Total cost = $786,633.12$

- **2006:** only 47 claims from one remaining group
  - $47 \times 7 = 329$
  - Paid day = $66.38$
  - Total cost = $21,840.45$

- STD costs went down $764,792 or 11% per EE
OCI Case Study

• Analysis on STD Plan Design
  > Waiting periods
  > Recurrent claim volume

• Utilized historical claims over a 4 year period to demonstrate the impact of plan design changes

• Eligible population for benefits was ~ 70,000 with incurred costs of $103M during time period

• Special thanks to OCI for sharing a small portion of the full study!
STD Claim Occurrence By Tenure

- 2.3 percent of claims are filed within 90 days of hire
- 3.1 percent of claims are filed within 90 & 180 days of hire
- 94.3 percent of claims are filed after 180 days of hire
STD Claim Occurrence By Tenure

- Human Resources and Managers were complaining that all their new hires were filing STD claims.
- Data revealed that the rate of claims filed within the first 180 days of hire is very low.
- The vast majority, 94.3%, of all claims are filed after the new employee reaches day 180.
- Allowed discussions around the pros and cons of not providing this safety net to new hires and realistic projections for cost savings.
Contrary to expectations, few claims are being filed within the first 180 days of employment. There was a higher percentage of claims being filed for each time period segment following 180 days.
Suggests that some claimants are coming back to work to get their benefits percentage back to 100% given that they go back out on leave.
Promoting Health and Productivity
Impact of Worksite Health Promotion on STD Usage

• “…participation in a reimbursement based health promotion program had a significant impact on STD usage.
• Employees receiving STD who participated in the health promotions program used an average of 6 fewer disability days….”
• Use your data to project an ROI

Source: JOEM Volume 43, Number 1, January 2001
Serxner, Gold, Anderson and Williams
Integration with Health Programs

• Provide incentives for employees to seek health coaching or disease management programs during the disability process
  > Approval of benefits can be dependent on participation in offered programs
  > Higher benefit rates can be paid for individuals who participate
  > One time incentive pay outs

• Key is to review your health benefit programs
  > Carved in or carved out?
  > If multiple plans: Do they all have a core group of services?
Lost Workdays per 100 Employees by Major Diagnostic Category (MDC)

Red bar represents total company view, blue is a single business unit comparison to total.
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Companies wanting to get a handle on how to reduce costs and absences covered by short-term disability need to take a look at their plan design. The predominant plan design features—from the length of the benefit elimination period to the level of wage replacement—can have a direct impact on how long employees are off work because of short-term disability.

From an HR standpoint, when presenting short-term disability outcome data—to senior management or as part of external benchmarking—it is essential to distinguish what results are attributable to plan design and therefore do not necessarily reflect on the effectiveness of your disability management program. Further, understanding how aspects of design have intended and unintended results will help produce a more effective and efficient plan.

**Maximum Length of Benefits**

One of the most obvious factors influencing employee behavior is maximum length of benefits, which may be as short as 90 days or as long as 52 weeks. Most short-term disability plans typically exhaust at 26 weeks because the majority of employees will return to work within six months.

The difference in maximum length of benefits is also important to note as companies benchmark their experiences against that of other employers.

- **Tip.** Unless the maximum length of benefits is the same, the duration comparisons will be skewed. For that reason, companies might want to do internal benchmarking between business units or divisions first.

**Wage Replacement**

Another plan design factor to consider is wage replacement. According to research by Kenneth Mitchell, vice president for health and productivity at UnumProvident, the “watershed level” wage replacement is 70 percent. “Over 70 percent increases lost time, and below 70 percent reduces lost time,” he reports.

Mitchell’s research noted that a key factor is “the number of individuals with lower wage replacements coming back to work prematurely.” Further, duration averages were at least 20 percent higher than normal when companies offered 100 percent income replacement.

There are other factors in short-term disability plan design that influence employee behavior. Among them:

- **Elimination period.** When do benefits start; for example on day 1, after 7 days, 14 days, 30 days? Are benefits retroactive to day one if the disability claim is approved?

- **Definition of disability.** Is the company’s definition of disability aligned with the return-to-work (RTW) policy, and does it promote participation in a transitional RTW program?

- **Relapse/recurrence.** How does the plan define a relapse or recurrence of a disability? When is the same condition considered a new claim?

**Elimination Period**
When an employee is first absent from work because of a non-occupational illness or injury, the first few days are usually covered by sick leave or paid time off (PTO). Then, after a set number of days (known as the elimination period), if an employee still cannot return to work a short-term disability claim is initiated.

Although elimination periods may range from 0 to 30 days, the industry best practice is seven days, with benefits beginning on the eighth day. This balances the use of PTO for short medical absences with the ability to promote timely clinical and RTW interventions in the disability management process.

- **Tip.** When managing short-term disability claims, early intervention is key to reducing costs and duration of absences. With longer elimination periods, there is little opportunity for early intervention and RTW planning to help the employee return to productivity, such as with a transitional work assignment.

The key component to evaluate, however, is not the length of the elimination period but the practice of retroactive benefit payment to day one. This can produce unintended effects on employee behavior.

Take, for example, the plan with a 30-day elimination period, which requires employees to exhaust PTO time first but will pay benefits to day one retroactively if the absence goes beyond 30 days—thereby reinstating the 30 days into the individual’s PTO bank. Although the intent is to reduce the incidence rate of short-term disability claims and thus costs, the opposite can occur. Employees might seek a doctor’s authorization for a longer absence beyond the 30-day limit in order to keep from using up their PTO, which most perceive as vacation time.

**Definition of Disability**

A best practice is to align the definition of disability with the company’s RTW policy, using language such as “any transitional assignment available” to promote employees returning to productivity.

- **Tip.** The definition of disability should not include language that would result in the unintended effect of employees being able to refuse a temporary or transitional assignment and continue to receive benefits when the company has identified productive work.

Definitions that include terminology such as “regular occupation” and “material and substantial duties” can lead to greater duration, higher litigation rates and union grievances as the parties dispute written job descriptions and focus on inconsistent practices across work units. The objective is to make sure that employees who have the ability to be productive in some capacity are at work.

As companies evaluate their plan design, the goal is to have greater continuity and consistency, particularly as it relates to RTW, explains Pamela Caggianelli, manager of corporate health for Bausch & Lomb Inc. in Rochester, N.Y., and chair of the Certification of Disability Management Specialists Commission (CDMSC). “It’s so much easier for a company to handle all employees who have the ability to work in this way,” she notes.

**Relapse/Recurrence**

Most short-term disability plans will define what is considered to be a continuation of a previous claim following a relapse or recurrence, and what is classified as a new claim. With some injuries (e.g., a broken arm) this is fairly straightforward. However, employees with chronic medical conditions may be off work for 30, 60 or even 90 days, come back to work for two weeks, and then be off again. This may be considered part of the same claim or trigger a new one, depending on the length of the relapse/recurrence period defined in the plan.

- **Tip.** If the recurrence period is too short, it is more difficult to determine whether the person is able to sustain permanent employment.
Although many insured plans have a standard of 14 days, self-insured plans that focus more on productivity outcomes embrace a relapse/recurrence cycle of at least 30 days to ensure alignment with RTW interventions.

Integration with Health and Productivity Programs

Employers should focus on addressing health and lost time in a coordinated way rather than with piecemeal programs, says George Faulkner, a principal at consultancy Mercer Health and Benefits.

• Tip. An emerging best practice in short-term disability plan design is to include greater coordination with health and productivity initiatives, which can provide incentives for employees to seek health coaching or disease management programs.

“This means vendor coordination, putting in place decision support systems with integrated data, and seamless, event-focused communications,” Faulkner advises.

There is already evidence of this best practice in evidence, Faulkner adds. The 2006 Mercer/Marsh Survey on Health, Productivity, and Absence Management Programs indicated that 12 percent of participants have integrated their health and disability programs in substantial ways. The survey found that 25 percent combine data from multiple programs on a regular basis using data warehouses, carriers or other resources, and another 33 percent were considering it.

“Not surprisingly, large employers often have the resources and dollars at stake to lead these efforts,” Faulkner observes. “While 17 percent of all survey participants have a strategy to achieve greater program integration, 25 percent of employers with 5,000 or more employees do.”
Plan Design and Expectations

For HR professionals, understanding the effects of plan design on employee behavior can help determine where problems lie when short-term disability costs, duration or other factors appear out of line with expectations. Rather than be surprised by results, employers are urged to analyze outcomes and examine employee behavior—even on an anecdotal level—to determine if the short-term disability plan design is the best for the company and the needs of the workforce.

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