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BENEFITS INSIGHTS

Choose or snooze?

Three lessons from behavioral economics that explain how employees make benefits decisions.

Employees love benefits, but they don’t always make good choices.

Once a year, the entire benefits smorgasbord is spread out and employees get to load their plates with whatever plans they want.

Sure, there are other qualifying life events that allow for some changes during the year, but annual enrollment is the Main Event.

If you’ve ever been to an all-you-can-eat buffet with a group of people, you know there are different ways to approach deciding what to eat. That’s because in life—as in benefits—we are guided in our decision-making by circumstances and preferences. Moderation and common sense may not factor into the equation.

As humans, given one or more options we sometimes make choices that can undermine our health, our financial well-being or our waistline.

Behavioral economists study our decision-making and provide insights into what drives our choices, and this applies to benefits choices as well.

A science of human behavior

Behavioral economics is a complex field of study that offers many distinct insights into our actions and choices, including those below.

These are just three of the forces at work when we make decisions, including when employees make benefits choices.

1. **Risk or loss aversion**
2. **Status quo bias**
3. **Outcome bias**

Let's take a look at each of these factors and how they can impact employees' benefits decisions.

1 Risk or loss aversion: Humans prefer a “sure bet”

People don’t like to lose, and we’re not talking about the outcome of a friendly badminton match (although losing there isn’t fun either.)

Loss aversion applies to material things—like money and possessions. Even if you have something for just a few minutes, it will almost immediately gain value and giving it up will feel like a loss. *(Schwartz)*

People prefer a surer thing over a riskier prospect that may end in them losing something they value. We generally don’t like parting with resources, whether they are hard-earned or given to us.

Behavioral economics tells us that “losses loom larger than gains,” with a loss feeling twice as bad as a comparable gain feels good. In other words, losing $100 feels twice as bad as winning $100.

It seems to be a fairly general principle that when making choices among alternatives that involve a certain degree of risk or uncertainty, we prefer a small, sure gain to a larger, uncertain one.

—Barry Schwartz, The Paradox of Choice

Our 2021 MyChoice® Recommendation Engine Benefits Insights Report demonstrates how employees feel about the prospect of paying for a large healthcare expense.

Most would have a visceral panic reaction. Others would just prefer not to. Both reactions demonstrate loss aversion.

How to you feel about facing a large Emergency Room Bill?

I'd feel panicked	44%
I could do it, but I prefer not to	45%
No worries, I'm fully prepared	11%

The potential benefits impact of loss aversion

When it comes to benefits decision-making, risk and loss aversion can be a double-edged sword.

- Employees may not want to spend money from their paycheck on coverage they actually need, which can lead to under-insuring. As they avoid spending, employees may choose the lowest-cost options and may not add optional coverages that will offer a safeguard against unforeseen costs.
- Feeling uncomfortable spending dollars on out-of-pocket costs can lead to over-insuring. In this case, employees might pick a more expensive health care plan with a lower deductible and then layer on more coverage from the optional category that they don't really need.

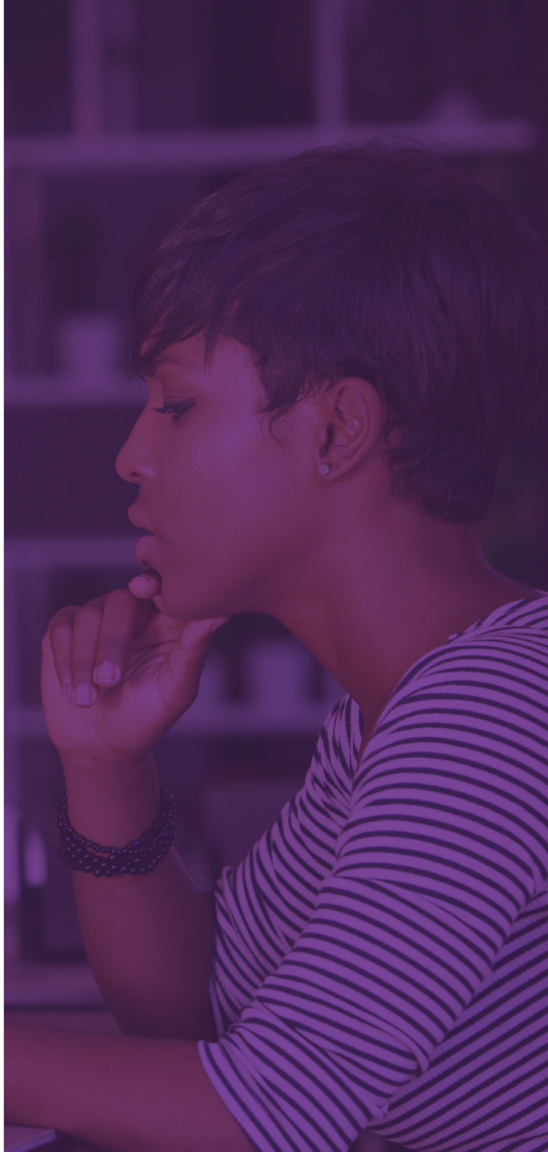
2 Choosing not to move: status quo bias

Human beings are creatures of habit. We generally don't like to change things up too much, preferring to stick with what we know. This is the basis for the old adage: Better the devil you know than the devil you don't know.

When dealing with a set of circumstances you're familiar with, you feel comfortable in your expectations.

Going back to the buffet analogy again, status quo bias is when you are presented with viable options but pick your old standard. There may be tastier dishes, but when you stay with the tried-and-true selection you know what to expect. You might not be bowled over, but you also won't be disappointed.

This is the status quo bias in action (or should we say in inaction?)



Passing on enrollment: inaction in benefits decision-making

Annual enrollment happens every year, but the overwhelming majority of employees (93%) make no changes to their elections.

Part of the reason is likely that their employer's annual enrollment period is a passive one. Tell employees they don't need to make complex benefits decisions and they'll take you at your word.

Back in the day, when benefits programs included fewer options, employees didn't actually have as much choice and they had less skin in the game in terms of financial exposure.

Today's employees have the ability to personalize their benefits (which they like) and that means more active decision-making (which they don't). Their contributions and potential out-of-pocket costs are higher, which means staying in the same plan year after year even when personal circumstances change can have significant short- and long-term financial effects.

Passive enrollment certainly enables status quo behavior, but it's not entirely to blame. Even when enrollment is passive, employees can still choose to make changes. They simply don't.

Most employees make no changes to their elections during annual enrollment

Source: Aflac

3 It worked out well last time: outcome bias can cloud judgement

Sometimes, even bad decisions yield good results. In these cases, the outcome is based more on luck or happenstance than on a well-informed choice. But, people tend to focus on the outcome more than on the process.

Here's an example of outcome bias.

> You're hungry and pressed for time. You root through the fridge and find a yogurt, but when you look at the container you see the expiration date is more than a week gone. You throw caution to the wind and eat it anyway—after all, you are starving and late for an appointment.
>
> Hours, then days pass. Nothing bad happens: You don't get sick, and the expired yogurt police don't show up at your door.
>
> As a result of this positive outcome, you believe you made a good decision. You're more likely to eat expired food the next time you're running late. In other words, future food choices will be colored because of the outcome of this expired-yogurt-eating decision.

In benefits, outcomes can create a false imperative

Anyone who has ever saved in their employer's 401(k) or 503(b) plan has seen a prospectus that includes a disclaimer along these lines: *Past results do not predict future returns.* In other words, don't rely on your outcome bias.

When employees make their benefits elections, they may look at how things turned out before choosing for the coming year.

But that doesn't always make sense.

Say a young and otherwise healthy employee has a skiing accident and ends up with more out-of-pocket medical costs than in any previous year. This employee had been enrolled in a high-deductible health plan (HDHP) for several years and had money in her HSA to cover the expenses. However, the outcome of having one year of high out-of-pocket costs can obscure the fact that the HDHP/HSA combination was—and continues to be—a good choice. At annual enrollment this employee may enroll in a higher-cost plan to insulate herself against out-of-pocket costs, even though the chance of another skiing accident is slim.

In this case, the previous outcome predisposes the employee to a potential set of choices based on past results that don't predict future reality.

Why it's important to bypass employees' mental shortcuts

Benefits are complex and making decisions about the right coverage isn't always easy, especially when employees don't understand benefits well. People often rely on mental shortcuts—called heuristics in behavioral economics—such as status quo or outcome bias when annual enrollment comes around. Add risk and loss aversion to the mix and it can be a recipe for poor choices.

There can be financial implications to choosing the wrong benefits, including under-insuring and not picking options that offer protection from unforeseen events. Think disability coverage, supplemental life insurance and hospital indemnity, among others.

There's also over-insurance, where employees load up on expensive options and plans they don't really need, potentially diverting dollars that could be better allocated to day-to-day needs, savings goals, health care accounts or retirement saving.

Employees need meaningful, effective support.

Helping employees choose with personalized guidance

With so many plans and programs to choose from, and so many options and costs to consider, most employees can't go it alone successfully. Without help they are forced to rely on an imperfect understanding of benefits, previous personal experience or choices they made in years past that may no longer be the right choices.

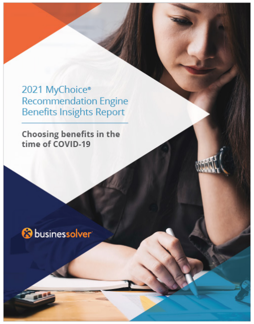
Just pulling up a chair for them at a yearly benefits buffet isn't enough. Employees need support during annual enrollment to understand their options and connect them to decisions based on their situation—not their lack of knowledge or desire to avoid making a choice.

When it's time to choose their benefits, employees need different types of guidance:

1. An enrollment experience that is easy to use and offers real-time, online support through a tech-enabled personal benefits assistant.
2. An integrated, online tool that takes into account the employee's personal situation and state of mind.
3. Access to live expert help for employees that want or need it.

When making benefits decisions, employees do what all humans faced with choices do: their best. But, this best is informed by some factors that may contribute to poor decisions and bad outcomes. Helping employees overcome these factors can lead to employees picking options that make the most sense for them which, by extension, is better for their employer too.

Want more insights into what employees are thinking when they make their benefits elections? Check out our MyChoice Recommendation Engine Benefits Insights Report for a closer look.



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