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EMPLOYERS AS RISKS

AMY B. MONAHAN*

INTRODUCTION

In the United States, employees have historically been highly dependent on employers for their retirement and health security. The reasons for this dependence are complicated, but it is driven in large measure by the tax code, which grants tax benefits to employer-provided health and retirement plans that are unavailable to individual purchasers. A primary feature of this employer-centric system is that an employee's ability to adequately control health and retirement risks, and therefore achieve health and retirement security, depends in large part on the decisions made by his or her employer. Lucky individuals work for employers that sponsor well-designed and well-managed health and retirement plans, while unlucky individuals have employers that decline to sponsor any benefit plans, or sponsor plans that continue to subject employees to significant risk.

This article begins in Part I by briefly cataloging retirement risks, and then evaluates how effective employers are at controlling such risks. The article concludes that employers do not very effectively manage retirement risks. Retirement risks are well known, and an extensive behavioral economics literature has established that certain plan designs can help control these risks. Nevertheless, many employers harm their employees' retirement security by failing to offer any plan at all. And among those employers that do offer plans, many ignore the significant amount of research on plan design and offer plans that either fail to minimize risk or in some cases exacerbate risk.

Generalizations similar to those made about employer-provided retirement plans are more difficult to make when it comes to employer health plans, but as Part II explains, after cataloging health-insurance related risks, there is reason to be concerned that employer plans do not adequately protect employees from such risks. Part III explores the reasons why employers often do not design plans that adequately protect their employees from

* Julius E. Davis Professor of Law, University of Minnesota Law School. I would like to thank Marty Malin and the entire Chicago-Kent Law School community for granting me the privilege of delivering the 35th Annual Kenneth M. Piper Lecture, and also Rob Meisburg and Stephen Sleight for their insightful comments on this lecture.

risk. The article concludes in Part IV by examining the role that law can play in reducing our system's current reliance on employer decision-making to control health and retirement risks, focusing on the recent example of the Affordable Care Act in mitigating health risks. The Affordable Care Act does not eliminate the role of employers in achieving health security, but what it should accomplish is to eliminate the significant element of luck that is present in our current system, by providing a federally regulated backstop for those individuals who are either not offered any health coverage by their employer, or offered coverage that fails to satisfy their preferences.

I. RETIREMENT RISKS

Retirement security is often described as resting on a three-legged stool.¹ In order for an individual to enjoy a secure retirement, she must depend on a combination of social security benefits, an employer-provided retirement plan, and personal savings.² There are perhaps reasons to be concerned about each of these three legs, but this article focuses only on the second, employer-provided retirement benefits.

Employers provide retirement benefits for a number of reasons. A basic reason that employers sponsor plans is to recruit and retain employees in industries where workers value such benefits.³ And retirement plans can also be used to create desired incentives for employee tenure and retirement.⁴ In addition, because certain tax benefits are available only through employer-sponsored plans, and not to individuals saving on their own, tax motivations often come into play for both employers and employees.⁵

Before the 1980s, most employers who offered retirement plans offered traditional defined benefit pension plans.⁶ These plans promised to pay workers a fixed benefit amount for as long as they lived following their retirement.⁷ Today, the majority of workers who are offered employer retirement plans are offered a defined contribution plan, most commonly a

1. See, e.g., ALICIA H. MUNNELL, 401(K) PLANS IN 2010: AN UPDATE FROM THE SCF 2 (CENTER FOR RETIREMENT RES., July 2012).

2. See *id.*

3. See Alan L. Gustman et al., *The Role of Pensions in the Labor Market: A Survey of the Literature*, 47 *Indus. & Labor Rel. Rev.* 417, 418-19 (Apr. 1994).

4. See TERESA GHILARDUCCI, *LABOR'S CAPITAL: THE ECONOMICS AND POLITICS OF PRIVATE PENSIONS* 2-3 (1992).

5. See I.R.C. §§ 401, 408 (West. 2006).

6. See James M. Poterba et al., *The Transition to Personal Accounts and Increasing Retirement Wealth: Macro and Micro Evidence* 12 (Nat'l Bureau of Econ. Research, Working Paper No. 8610, 2001).

7. See I.R.C. § 401(a)(11).

401(k) plan,⁸ that does not guarantee a benefit amount and depends for its success on sound employee decision-making.⁹ The shift from defined benefit plans to defined contribution plans is often described as one that has shifted risk away from the employer and onto the employee.¹⁰ The section below will take a closer look at retirement savings risks to understand better how employer plans protect against or contribute to certain risks.

A. A Brief Taxonomy of Retirement Savings Risks

Perhaps the primary risk related to retirement is simply the risk of inadequate savings. Individuals who are left to make savings decision on their own may, for a variety of reasons, save at a level that is insufficient to support them in retirement.¹¹ While classic economic theory holds that rational individuals would not, in fact, under-save,¹² behavioral economists have provided ample evidence that many cognitive biases interfere with savings decisions.¹³ For example, individuals often use a hyperbolic discounting rate in making long-term savings decisions: they give current

8. Craig Copeland, *Retirement Plan Participation and Asset Allocation, 2010*, 34 EMP. BENEFIT RES. INST. NOTES 9, 11 (Apr. 2013) (finding that among working heads of household who participated in an employer-sponsored retirement plan, 18.9% participated only in a defined benefit plan, 65% participated only in a defined contribution plan, and 16.1% participated in both).

9. See Amy B. Monahan, *Addressing the Problem of Impatients, Impulsives and Other Imperfect Actors in 401(k) Plans*, 23 VA. TAX REV. 471, 480-481 (2004).

10. See generally Edward A. Zelinsky, *The Defined Contribution Paradigm*, 114 YALE L.J. 451 (2004); James M. Poterba, *Individual Decision Making and Risk in Defined Contribution Plans*, 13 ELDER L.J. 285 (2005); Susan J. Stabile, *Is It Time to Admit the Failure of an Employer-Based Pension System?*, 11 LEWIS & CLARK L.R. 305 (2007).

11. See, e.g., Jack VanDerhei & Craig Copeland, Issue Brief, *The EBRI Retirement Readiness Rating: Retirement Income Preparation and Future Prospects*, EMP. BENEFIT RES. INST. ISSUE BRIEF 1 (July 2010) (estimating that 47.2% of early baby boomers are at risk of not having sufficient resources to pay for basic retirement expenditures and uninsured health costs). One large administrator of 401(k) plans recently reported that the average 401(k) plan balance for those ages 65-69 was \$136, 800. Jill Schlesinger, *The Latest on America's 401(k)s*, CHI. TRIBUNE, Feb. 27, 2013, available at http://articles.chicagotribune.com/2013-02-27/business/sns-201302271600—tms—retiremsctrns-a20130227-20130227_1_retirement-savings-fidelity-plans-fidelity-investments.

12. See Monahan, *supra* note 9, at 473.

13. See, e.g., Julie R. Agnew & Lisa R. Szykman, *Asset Allocation and Information Overload: The Influence of Information Display, Asset Choice, and Investor Experience*, 6 J. BEHAV. FIN. 57 (2005); Shlomo Benartzi & Richard H. Thaler, *Heuristics and Biases in Retirement Savings Behavior*, 21 J. ECON. PERSP. 81 (2007); James J. Choi et al., *For Better or Worse: Default Effects and 401(k) Savings Behavior*, in PERSPECTIVES ON THE ECONOMICS OF AGING (David A. Wise ed., 2004); Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q.J. ECON. 1149 (2001); Olivia Mitchell & Stephen Utkus, *Lessons from Behavioral Finance for Retirement Plan Design* (Pension Research Council Working Paper No. 2003-06, 2003). For a helpful overview of the literature on retirement savings decisions, see Melissa A.Z. Knoll, *The Role of Behavioral Economics and Behavioral Decision Making in American's Retirement Savings Decisions*, 70 SOC. SEC. BULL. 1 (2010).

consumption greater weight than future consumption.¹⁴ They also often procrastinate in both making and implementing savings decisions,¹⁵ and are unduly influenced by defaults and framing effects.¹⁶ According to standard economic theory, a participant's decisions within a 401(k) plan should not be affected by the plan's defaults. For example, changing the plan's default from non-participation, absent an affirmative election, to automatic participation, unless the participant opts-out, should not change participation rates because individuals will make rational decisions about participation regardless of defaults. Several studies have shown, however, that defaults do matter. Automatically enrolling participants in 401(k) plans increases rates of participation.¹⁷ Similarly, automatically increasing participants' contribution rates raises contribution rates compared to plans where participants must take affirmative action to increase their contribution rate.¹⁸ Participants are also affected by how choices are framed, despite the fact that economic theory would predict no difference. For example, participants tend to elect the "middle" investment option rather than making an independent evaluation of investment funds.¹⁹ There is also, of course, a more basic impediment, and that is that retirement savings decisions are very complex. They require an individual to determine when they are going to retire, the standard of living they would like to achieve in retirement, how long they are going to live after retirement, and how much money such a living standard of that length will require, among many other factors. To get these calculations correct, the individual must determine their anticipated rate of return on investments and adjust for rates of inflation. Such complex decision-making often is difficult even for expert decision makers.²⁰

Even if an individual chooses an optimal savings rate, incorporates reasonable assumptions about investment returns and inflation, and implements that decision in a timely manner, retirement savings are also subject to investment risk. That is, an individual may fail to achieve financial security in retirement if her investment returns do not equal or exceed the return assumptions she made in calculating her retirement savings needs.

14. See, e.g., David Laibson, *Golden Eggs and Hyperbolic Discounting*, 112 Q. J. ECON. 443 (1997).

15. See Knoll, *supra* note 13, at 1.

16. See, e.g., Choi et al., *supra* note 13; Madrian & Shea, *supra* note 13.

17. See, e.g., Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving*, 112 J. POL. ECON. S164 (2004).

18. See *id.*

19. See, e.g., Agnew & Szykman, *supra* note 13.

20. Russell Korobkin, *The Efficiency of Managed Care "Patient Protection" Laws: Incomplete Contracts, Bounded Rationality, and Market Failure*, 85 CORNELL L. REV. 1, 50-51 (1999).

Because retirement savings are achieved over several decades, there is also the risk of financial shock. This risk actually has two, interrelated parts. The first is the risk that an individual will experience a financial shock pre-retirement and be unable to access a source of her wealth because it is in a retirement savings vehicle that is unavailable prior to retirement. Nevertheless, if an individual *can* access such amounts pre-retirement, there is an additional risk that the individual's retirement savings will be depleted pre-retirement by using such savings to absorb a pre-retirement financial shock.

Finally, even if an individual has made sound retirement savings decisions, met investment expectations, and not depleted her savings pre-retirement, there is the risk that the individual will outlive her retirement savings. This risk is commonly referred to as longevity risk.²¹

B. How Effective Are Employers at Controlling Retirement Risks?

Given the various risks inherent in saving for retirement through a 401(k) plan,²² this part will analyze both how retirement risks can be controlled through plan design, and whether employers utilize such risk mitigation techniques. The very first risk, inadequate savings, is perhaps most directly impacted by an employer's decision to offer any type of retirement savings vehicle. If an employer fails to offer a plan, the employee's only tax-favored savings option is to establish an individual retirement account (IRA).²³ Forcing an individual to establish an IRA on their own increases the risk of inadequate savings for an employee because he or she will have to research a large number of providers, select from limitless investment options, and overcome inertia and procrastination to actually establish an account and begin contributing. On top of that, IRAs have much lower

21. See, e.g., Zelinsky, *supra* note 10, at 462.

22. This part will focus on defined contribution plan design for two reasons. First, defined benefit plans to a large degree protect against many of these risks. Such plans require no affirmative action on the part of participants to enroll or choose a savings level; they protect pension wealth prior to retirement; and they provide a lifetime income stream as the normal form of benefit. While such plans do come with the risk of plan insolvency, federal insurance through the Pension Benefit Guarantee Corporation fully protects against this risk for most plan participants. Indeed, the greatest risk for defined benefit plan participants appears to be that the plan will shift too much consumption into retirement for an individual that has alternative sources of retirement wealth. The second reason that defined contribution plans are the focus is a very practical one; the majority of working Americans are offered only a defined contribution plan.

23. See I.R.C. §§ 408, 408(a) (West, 2006). While an individual could save an unlimited amount on an after-tax basis, pre-tax savings of an equal amount will typically result in greater net savings. While pre-tax savings are eventually taxed at the time of distribution, the individual will generally enjoy greater net savings because she has been able to earn compounding investment returns on the full pre-tax investment, and tax rates are likely to be lower post-retirement, when the individual presumably has less income.

annual contribution limits than 401(k) plans. In 2013, an individual could contribute \$17,500 of her salary tax-free to a 401(k) plan,²⁴ but could only contribute \$5,500 of tax-free dollars to an IRA.²⁵

When we examine just this risk to an employee's retirement security, we see that there is significant room for improvement in employer behavior. Only 45% of firms in private industry offered employees any type of retirement plan in 2012, although the rate varies significantly by firm size and industry.²⁶ While fewer than half of all firms in private industry offer plans, because plans are more likely to be offered by larger firms, 65% of all workers within private industry had access to a retirement plan through their employer.²⁷ Nevertheless, the end result is that over one-third of all workers in private industry lack access to one of the three legs upon which retirement security rests.

Even when employers offer plans, not all workers elect to participate. Among those workers in private industry offered a defined contribution retirement plan, only 70% participate.²⁸ Behavioral economists theorize that one reason that participation rates are relatively low is that 401(k) plans have traditionally require participants to take affirmative steps to enroll in the plan. Because inertia is powerful, and individuals tend to procrastinate, setting the default as non-participation is thought to harm enrollment. When this theory was tested, the results were clear that an employer electing to change the 401(k) plan default to participation (unless the participant opts out) dramatically increases rates of participation.²⁹ This process of defaulting eligible employees into the plan is referred to as "automatic enrollment." Despite the clear evidence of increases in participation, and regulatory incentives offered to plans that offer certain automatic enrollment arrangements, fewer than half of all employers that sponsor 401(k) plans automatically enroll participants.³⁰

24. INTERNAL REVENUE SERV., INTERNAL REVENUE BULLETIN 2012-50, 2013 LIMITATIONS ADJUSTED AS PROVIDED IN SECTION 415(D), ETC. (2012).

25. *Id.*

26. DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, EMPLOYEE BENEFITS SURVEY tbl.1 (2012), available at <http://www.bls.gov/ncs/ebs/benefits/2012/ownership/private/table01a.pdf>.

27. See *id.* at tbl.2, available at <http://www.bls.gov/ncs/ebs/benefits/2012/ownership/private/table02a.pdf>.

28. *Id.*

29. See, e.g., Thaler & Benartzi, *supra* note 17, at S173 (finding automatic enrollment increased participation rates by 17 percentage points at one company); John Beshears et al., *The Importance of Default Options for Retirement Savings Outcomes: Evidence from the United States* 4-6 (Nat'l Bureau of Econ. Research Working Paper No. 12009, 2007) (finding automatic enrollment increased participation rates by 25 to 35 percentage points at one company).

30. See MUNNELL, *supra* note 1, at 2. (finding that fewer than half of all 401(k) plans offered automatic enrollment in 2010).

As important as it is to get eligible employees to participate in their employer's 401(k) plan, it is also critical that the employee participate at a level that will meet his or her retirement savings needs. A common rule of thumb is that an individual should, on average, save 15% of income over her working life in order to ensure adequate income in retirement.³¹ Among all participants in 401(k) plans, the average contribution rate is between 7.5 and 8% of income.³²

But here, too, there are well known plan design features that an employer can adopt in order to encourage employees to increase the rate at which they save. One method is for an employer to provide a matching contribution in order to encourage employees to save at a specific level. For example, if an employer wanted to encourage employees to save 15% of their income, it could offer a 50% matching contribution on the first 10% of compensation the employee contributed. The employee would be irrational in most cases to contribute anything less than 10% to the plan, as he or she would make an instant 50% profit upon contribution.³³ Most employers do offer matching contributions,³⁴ but the most common formula is to match 50% of the first six percent of salary contributed.³⁵ If a participant maximized her matching contribution under this formula, she would end up with total contributions to the plan of only 9% (the employee would contribute six percent of salary in order to maximize the matching contribution; the matching contribution would be equal to fifty percent of the employees' contribution, or three percent of salary, for a total of nine percent). By tying the maximum matching contribution to an employee contri-

31. See e.g., AON HEWITT, *THE REAL DEAL: 2012 RETIREMENT INCOME ADEQUACY AT LARGE COMPANIES* 3 (2012), available at http://www.aon.com/attachments/human-capital-consulting/The_2012_Real_Deal_Highlights.pdf.

32. See Craig Copeland, *401(k)-Type Plans and Individual Retirement Accounts (IRAs)*, 28 EMP. BENEFITS RES. INST. NOTES 2, 6 (Oct. 2007) (analyzing the average contributions by family income level); *Fidelity Average 401(k) Balance Climbs to Record High at End of 2012*, FIDELITY INVS. (February 14, 2013), <http://www.fidelity.com/inside-fidelity/employer-services/fidelity-analysis-finds-record-high-average-401k-balance> (reporting 8% average deferral rate among Fidelity 401(k) plan participants).

33. Yet many participants do fail to take full advantage of matching contributions. See James J. Choi et al., *\$100 Bills on the Sidewalk: Suboptimal Investment in 401(k) Plans*, 93 REV. ECON. STAT. 748 1 (2011).

34. See THE VANGUARD GRP., *HOW AMERICA SAVES 2013: A REPORT ON VANGUARD 2012 DEFINED CONTRIBUTION PLAN DATA* 13 (2013), available at <https://institutional.vanguard.com/iam/pdf/HAS13.pdf>. (82% of plans offered a matching contribution); DELOITTE, *ANNUAL 401(K) BENCHMARKING SURVEY* 13 (2012), available at http://www.deloitte.com/assets/Dcom-United-States/Local%20Assets/Documents/Consulting/us_cons_hc_401ksbeenchmarkingsurvey2012.pdf (95% of plans sponsors offer matching and/or profit sharing contributions).

35. VANGUARD, *supra* note 34, at 13; DELOITTE, *supra* note 34, at 13.

bution of six percent, the employer is likely sending a signal to employees that six percent is the ideal employee contribution rate, which may work against adequate savings. It is also important to keep in mind that, although matching contributions are powerful incentives to save a specific amount, in practice not all participants contribute enough to maximize the matching contribution.³⁶

Another well-established method to increase savings rates is to implement automatic contribution rate increases at specified intervals.³⁷ Most commonly, these automatic increases are implemented along with automatic enrollment, but the two do not need to be tied together. For example, a plan might provide that the initial default contribution rate is 3%, but that the rate will increase at 1% per year until the individual is saving 10% of her income. Because these are changes to defaults only, a participant is always free to lower his or her contribution rate, but needs to take affirmative action to do so. Nevertheless, the change to the default is so powerful that the federal government has provided various incentives to encourage employers to choose to incorporate automatic enrollment with increasing contribution rates into their 401(k) plans.³⁸ While many employers have adopted such plan designs, more have elected not to do so. Among those plans that automatically enroll participants, the average default contribution rate is 3% of salary, and only 34% of plans automatically increase that default rate over time.³⁹

Another significant risk faced by 401(k) plan participants is investment risk. Individuals appear to make frequent mistakes when investing long-term savings,⁴⁰ and many do not understand even basic principles of investing.⁴¹ These investors may subject themselves to unnecessary risk while failing to maximize return.

A defined contribution plan can be designed to lessen the employee's investment risk in various ways. Under the assumption that an employer may be a more sophisticated investor than its employees, an employer could invest plan assets on behalf of the participants in a defined contribution plan. Nothing prevents an employer from doing so. The likely reason

36. See HEWITT ASSOCS. LLC, HOW WELL ARE EMPLOYEES SAVING AND INVESTING IN 401(K) PLANS: 2010 HEWITT UNIVERSE BENCHMARKS (2010) (finding that 72% of plan participants contributed enough to maximize their matching contribution).

37. See Thaler & Benartzi, *supra* note 17, at S170.

38. See I.R.C. § 401(m)(12) (West, 2006).

39. VANGUARD, *supra* note 34, at 20; DELOITTE, *supra* note 34, at 10.

40. See, e.g., Agnew & Szykman, *supra* note 13, at 57.

41. It is important to note that sophisticated investors are, of course, much less susceptible to investment risk and can do very well at both controlling investment risk and maximizing return in their 401(k) plans.

we do not see many employers offer this option is the potential legal liability that would result from such a plan design.⁴² Employers would be subject to legal challenge if their investments appeared imprudent to participants. In addition, even unsophisticated employees may not feel comfortable allowing employers to make investment decisions when the employees bear any resulting losses.

Another method of dealing with investment risk in the defined contribution context is for the employer to choose investment defaults in a manner that takes into account the likely mistakes that individual investors may make. This would involve employers choosing an investment default that, according to accepted principles of investing, is appropriate for that employee's time to retirement.⁴³ Another option, currently being utilized by at least one large company, is to offer employees guaranteed returns using annuity contracts as investments.⁴⁴ Under any of these investment risk mitigation techniques, an employer could at the same time offer unrestricted investment options through a brokerage window once a certain minimum balance has been achieved, thereby accommodating even the most sophisticated investors. Again, only the defaults would change.

The evidence regarding how well employers help employees to manage investment risk is mixed at best. Among employer plans that utilize automatic enrollment, ninety-one percent default participants into an age-appropriate investment option.⁴⁵ While the selection of an age-appropriate default investment option does not ensure protection against investment risk, it at the very least suggests that an employer is taking steps to help protect employees.

However, most plans do not utilize automatic enrollment. Participants in 401(k) plans generally must select their investments from a large menu of options. On average, 401(k) plans offer participants a choice of over

42. Such an investment option is so uncommon that the large 401(k) surveys do not track such arrangements. See DELOITTE, *supra* note 34; VANGUARD, *supra* note 34.

43. Target date funds would be one choice that would provide the desired personalization and one-stop shopping. See JULIE R. AGNEW ET AL., WHAT PEOPLE KNOW ABOUT TARGET-DATE FUNDS: SURVEY AND FOCUS GROUP EVIDENCE 4 (May 2011), available at <http://crr.bc.edu/wp-content/uploads/2011/05/FSP-WP-2011-2.pdf>. But see Zvi Bodie et al., *Unsafe at Any Speed? The Designed-in Risks of Target-Date Glide Paths*, 23 J. FIN. PLAN. 42 (March 15, 2010), available at <http://www.fpanet.org/journal/CurrentIssue/TableofContents/UnsafeatAnySpeed/> (Analyzing the risks of target date funds).

44. For an example of a plan that utilizes annuities in this manner, see Tara Seigel Bernard, *A 401(k) The Promises Never to Run Dry*, NY TIMES (Nov. 13, 2012), http://www.nytimes.com/2012/11/14/your-money/a-401-k-that-promises-income-for-life.html?_r=0.

45. VANGUARD, *supra* note 34, at 20. Note that the fact that a large percentage of plans utilizes an age-appropriate investment default does not necessarily indicate that the age-appropriate investment option is in fact a good investment option. It may be that the default fund, while age appropriate, has high fees.

eighteen investment funds.⁴⁶ Yet research demonstrates that participants struggle to choose effectively among such a large number of options. When faced with a large investment menu, participants increasingly use decision-making shortcuts, such as simply dividing their contributions equally among all available investment options,⁴⁷ or by electing to invest in what is framed within the plan as the middle or moderate investment option.⁴⁸

Yet another type of investment risk is present in many 401(k) plans, and that is investment options with high fees. High fees can easily diminish a fund's investment returns over time. And yet there is significant evidence that many 401(k) plan participants end up in investment options with high retail-level fees, in many cases because those are the only funds the employer has chosen to offer within the plan.⁴⁹ As a result, even where the employer might offer age-based portfolios as the default investment option in its 401(k) plan, and offer an additional broad menu of investment options, an employee may nevertheless be put at significant risk if nearly all of those investments have high fees.⁵⁰ Overall, many employers appear to unnecessarily expose participants to investment risk through too much choice and high investment fees.

Plans also appear to be poorly designed to protect against at least one of the financial shock risks. Recall that one financial shock risk is the risk of being unable to access retirement wealth prior to retirement and therefore being unable to respond to pre-retirement financial emergencies, while the interrelated risk is the risk of depleting retirement savings prior to re-

46. VANGUARD, *supra* note 34, at 46 (reporting that, on average, Vanguard administered plans offer 18 funds); See also *55th Annual Survey Highlights*, PLAN SPONSOR COUNCIL OF AM. (2012), available at <http://www.pasca.org/55th-annual-survey-highlights>.

47. See Maureen Morrin et al., *Investing for Retirement: The Moderating Effect of Fund Assortment Size on the 1/N Heuristic*, 49 J. MARKETING RES. 537, 537-550 (2012).

48. See Mercer Bullard, *The Social Costs of Choice, Free Market Ideology and the Empirical Consequences of the 401(k) Plan Large Menu Defense* 26-36 (May 10, 2013)(unpublished manuscript) (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2263353) (discussing the various ways in which large numbers of investment options within 401(k) plans harm participants).

49. *Id.* at 6; Ian Ayres & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans* 13-20 (Feb. 21, 2014) (unpublished manuscript) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2399531.

50. For an overview of general fee levels within 401(k) plans, see DELOITTE, *supra* note 34, at 15 (finding that 1% of 401(k) plans had an average weighted expense ratio of more than 1.25%, eleven percent of plans had an average weighted expense ratio of between .86% and 1.25%, thirty-six percent of plans were between .51 and .85%, thirty-one percent were at .5 or less, while a full 21% of survey respondents did not know their plan's average weighted expense ratio). While it is difficult to compare 401(k) plan fees to those incurred by investors outside of 401(k) plans, see DELOITTE, *DEFINED CONTRIBUTION/401(K) FEE STUDY* (2009), available at http://www.ici.org/pdf/rpt_09_dc_401k_fee_study.pdf; Emily Gallagher, Inv. Co. Inst., *Trends in the Expenses and Fees of Mutual Funds, 2012*, 19 ICI RES. PERSP. 1 (Apr. 2013), available at <http://www.ici.org/pdf/per19-03.pdf> (providing information on mutual fund fees outside of the 401(k) plan context).

tirement. While categorizing the inability to access retirement wealth prior to retirement goes against financial planning orthodoxy, I see this risk as a real risk. For some individuals, it may be preferable to utilize retirement savings than to declare bankruptcy, lose a principal residence, or be unable to receive medical treatment. This is not to argue, however, that pre-retirement access to savings should be easy. Rather, it is an argument that there are legitimate reasons to allow pre-retirement access to savings under the right circumstances. Existing law permits, but does not require, plans to allow both hardship distributions and loans prior to retirement.⁵¹

Plan loans are, in most circumstances, preferable to hardship withdrawals because a plan loan requires an individual to repay the loan, with interest that accrues to the participant's benefit. A hardship distribution, on the other hand, permanently removes savings from a participant's account, results in taxation of the distribution and, in most circumstances, an additional 10% tax penalty for the early withdrawal.⁵² The result is a very significant decrease in retirement wealth for individuals that receive hardship distributions. Loans are potentially problematic, too, if they can be used for any purpose as under current law. Where plans offer unrestricted loans, a participant can too easily view their plan account balance as an ordinary savings account, and use it to finance current consumption (such as a new car, or a desired vacation). An employer could try to mitigate the interrelated financial shock risks into account by allowing participants pre-retirement access to savings through loans, but only for specified purposes.⁵³ The employer could then offer hardship withdrawals only where the participant has established that plan loan repayments would themselves be a financial hardship.

There is little evidence that employers design their plans in such a manner. The vast majority of participants in 401(k) plans have access to plan loans,⁵⁴ which some studies suggest have the additional benefit of

51 I.R.C. § 72(p) (West 2012); Treas. Reg. §1.401(k)-1(d)(3)(i).

52. See I.R.C. §§ 72(p)(1) & (t) (West. 2012).

53. One easy method of limiting loan availability would be to make loans available only for expenses that the IRS deems to constitute "immediate and heavy" financial need for purposes of hardship withdrawals. Such expenses include: (1) certain medical expenses; (2) costs relating to the purchase of a principal residence; (3) tuition and related educational fees and expenses; (4) payments necessary to prevent eviction from, or foreclosure on, a principal residence; (5) burial or funeral expenses; and (6) certain expenses for the repair of damage to the employee's principal residence. Treas. Reg. §1.401(k)-1(d)(3)(i).

54. John Beshears et al., *The Availability and Utilization of 401(k) Loans 1* (HKS Faculty Research Working Paper Series, Working Paper No. 11-023, 2011), available at http://dash.harvard.edu/bitstream/handle/1/5027953/RWP11-023_Madrian_alia.pdf (finding that 90% of participants in 401(k) plans had access to plan loans). See also VANGUARD, *supra* note 34, at 79 (finding that 76% of all Vanguard-administered plans offered loans).

increasing plan participation and savings rates.⁵⁵ There is no evidence that employers limit the purposes for which plan loans can be requested. While relatively few participants have outstanding loans at any given time, almost half of all participants who are able to receive a plan loan will take one within a seven-year period.⁵⁶ In general, participants with lower income are more likely to take a plan loan than those with higher income.⁵⁷ Up to a third of loans are reported to be used to purchase or improve a principal residence, while purchasing a vehicle or other durable good accounts for 10 to 23% of loans, and educational and medical expenses combined account for another 5 to 16% of loans.⁵⁸ Another survey, which asked more detailed questions about loan utilization, found that 39% used plan loans to pay off or consolidate bills, while very few loans were used for pure consumption.⁵⁹ Of those who terminate employment with a loan outstanding, 80% default on the loan.⁶⁰ This default results in the taxation of the outstanding loan amount, along with an additional 10% tax penalty for most individuals.⁶¹ The good news is that while loans are widely available, and relatively heavily utilized, most are paid back. As a result, loans are likely the least-troubling form of pre-retirement access in terms of their effect on retirement security.⁶²

Hardship distributions are also widely available, with 82% of employers allowing for plan distributions where financial hardship has been established.⁶³ Perhaps because of the negative tax and retirement savings consequences, or perhaps because of the restrictions on the purposes for which such withdrawals can be granted, hardship withdrawals are utilized at a lower rate than plan loans, with only 2% of all participants taking ad-

55. See, e.g., U.S. GOV'T ACCOUNTABILITY OFFICE, GAO/HEHS-98-5, 401(K) PENSION PLANS - LOAN PROVISIONS

ENHANCE PARTICIPATION BUT MAY AFFECT INCOME SECURITY FOR SOME (1997); Olivia Mitchell et al., *Turning Workers into Savers? Incentives, Liquidity, and Choice in 401(k) Plan Design*, 60 NAT'L TAX J. 469 (Sept. 2007); Sarah Holden & Jack VanDerhei, *Contribution Behavior of 401(k) Plan Participants*, 7 ICI PERSP. 1 (Oct. 2001).

56. Beshears et al., *supra* note 54, at 12.

57. VANGUARD, *supra* note 34, at 81.

58. Beshears et al., *supra* note 54, at 16.

59. *Id.*

60. Timothy (Jun) Lu et al., *An Empirical Analysis of 401(k) Loan Defaults 2* (2010) (Fin. Literacy Ctr., Working Paper No. WR-799-SSA, Oct. 2010), available at http://www.prgs.edu/content/dam/rand/pubs/working_papers/2010/RAND_WR799.pdf.

61. I.R.C. §§ 72(p)(1) & (t) (West. 2012).

62. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-715, 401(K) PLANS: POLICY CHANGES COULD REDUCE THE LONG-TERM EFFECTS OF LEAKAGE ON WORKERS' RETIREMENT SAVINGS 20 (2009), available at <http://www.gao.gov/assets/300/294520.pdf>.

63. VANGUARD, *supra* note 34, at 84.

vantage of the distributions during the year.⁶⁴ Nevertheless, because they represent a permanent reduction in retirement wealth, they can have a very significant impact on retirement income. The U.S. Government Accountability Office reported that in 2006, \$9 billion of 401(k) retirement wealth was lost through hardship withdrawals.⁶⁵ They found that such withdrawals have the greatest impact on young and low-income workers.⁶⁶ A low-earning thirty-five year-old worker who took a \$5,000 hardship withdrawal is estimated to lose 12% of her retirement income as a result of taking the hardship withdrawal, whereas a higher-earning participant of the same age would lose less than 5% of her retirement wealth because of her higher overall contributions to the plan.⁶⁷ Despite the clear long-term risks associated with hardship withdrawals, few employers inform participants requesting such distributions of these risks.⁶⁸

The final risk identified was longevity risk—the risk of outliving one’s retirement savings. Employers can easily address this risk by offering participants the option of receiving their account balance in the form of an annuity, if not making it the normal form of distribution. This is one area where employers clearly fail to minimize their employees’ risk. Defined contribution plans almost always offer a lump sum distribution as the normal form of benefit and the vast majority do not offer any type of annuitization through the plan.⁶⁹ Instead, participants are left to either purchase an annuity themselves, or to self-annuitize.⁷⁰

By examining retirement savings risks in more detail, it seems clear that many risks can be at least partly addressed through plan design and without interfering with employee choice. The evidence is also clear that most employers fail to do so, and rather than safeguarding their employees against retirement risks, the employers’ choices contribute to such risks.

64. VANGUARD, *supra* note 34, at 84.

65. U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 62, at 17.

66. *Id.* at 19.

67. *Id.* at 19-20.

68. *Id.* at 26-27.

69. See INTERNAL REVENUE SERV., SECTION 401(K) COMPLIANCE CHECK QUESTIONNAIRE 47 (Feb. 2012), available at http://www.irs.gov/pub/irs-tege/401k_interim_report.pdf (finding that 99% of 401(k) plans offer a lump sum distribution, while only 19% offer a qualified joint and survivor annuity). See also HEWITT ASSOCS., TRENDS AND EXPERIENCES IN 401(K) PLANS 7 (2009), available at http://www.retirementmadesimpler.org/Library/Hewitt_Research_Trends_in_401k_Highlights.pdf (finding that all 401(k) plans offered a lump sum option, while 14% offered annuities).

70. See Lawrence A. Frolik, *Protecting Our Aging Retirees: Converting 401(k) Accounts into Federally Guaranteed Lifetime Annuities*, 47 SAN DIEGO L. REV. 277, 285-86 (2010) (explaining the process of managing retirement wealth to produce an income stream in retirement).

II. HEALTH RISKS

Just as there are complex reasons why most working individuals save for retirement through an employer-sponsored arrangement, so too are there complex reasons why employers dominate health insurance coverage. First, the market for individually purchased health insurance has not functioned well in most states due to various forms of market failure. In states that allow health insurers to medically underwrite policies, sick or risky individuals often face premiums that are unaffordable, or they are simply denied coverage.⁷¹ And in states that require health insurers to price coverage based on community-level risk, low-risk individuals are less likely to buy insurance, thereby raising the overall risk level for the insured population, driving premiums to levels that fewer individuals can afford even at “average” prices.⁷² In contrast, employers have several significant advantages over the individual market. First, employees can pay for employer-provided coverage with tax-free dollars, lowering the effective price of such coverage.⁷³ By lowering the price of coverage, the tax benefit helps to get low-risk individuals into the group of insureds, thereby bringing the risk level of the group down and further lowering costs compared to the individual market.⁷⁴ Second, employers, particularly large employers, enjoy significant economies of scale and have much lower overhead costs than individual health insurance providers, again lowering the price of coverage compared to the individual market. And finally, large employers benefit from the law of large numbers, which ensures that their group of insured individuals, which was formed for reasons unrelated to health insurance purchase, will have average risk levels—unlike individual insurance markets which often have a riskier-than-average group of insureds.

In addition to the better market conditions associated with group coverage, there are also human resource motivations associated with offering health coverage. Employers who offer health insurance have the benefit of knowing that ill employees (and usually their family members) will be able to access needed medical care, thereby reducing absenteeism and other

71. See Mary Crossley, *Discrimination Against the Unhealthy in Health Insurance*, 54 U. KAN. L. REV. 73, 109-113 (2005).

72. See, e.g., George A. Akerlof, *The Market for “Lemons”: Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970); see also Michael Rothschild & Joseph Stiglitz, *Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information*, 90 Q.J. ECON. 629, 634-37 (1976).

73. See I.R.C. §§ 106 & 125 (West. 2013).

74. See Amy B. Monahan, *The Complex Relationship Between Taxes and Health Insurance*, in BEYOND ECONOMIC EFFICIENCY IN UNITED STATES TAX LAW 137, 146-47 (David A. Brennan et al., eds., 2013).

related issues that can affect an employer's workforce.⁷⁵ And like retirement plans, health plans are a way for employers to compete for desired employees in a tight labor market,⁷⁶ particularly given the fact that employer-provided coverage has advantages that are unavailable to individuals purchasing coverage on their own.

While employer plans have been a significant source of health insurance for working Americans for many decades, how employers choose to structure their plans has changed in ways that are significant from a risk perspective. Historically, health insurance in this country was based on fee-for-service reimbursement.⁷⁷ If a covered individual incurred a covered expense, the plan paid the provider for the service performed.⁷⁸ The problem with this structure is that it potentially leads to the overutilization of medical services, driven by providers who stand to earn more money the more services they perform.⁷⁹ As a result, a movement toward managed care plans began in the 1980s.⁸⁰ Under managed care plans, financing and delivery are integrated and participating providers face various financial incentives to limit the amount of care provided.⁸¹ While managed care plans gained significant market share in the 1990s, a backlash against managed care plans has since decreased their popularity.⁸² Managed care plans that gave doctors incentives to withhold care created a conflict between doctor and patient that was not popular.⁸³ As a result, most employers that currently offer health plans offer hybrid plans (such as Preferred Provider Organizations or Point of Service plans) that share certain features of managed care plans, but also give patients greater flexibility to receive care without a physician-gatekeeper controlling access.⁸⁴ In recent years, in an effort to better address cost containment, so-called consumer-driven health

75. See, e.g., Ellen O'Brien, *Employers' Benefits From Workers' Health Insurance*, 81 MILBANK Q. 5 (2003).

76. See *id.*

77. William D. White, *Market Forces, Competitive Strategies, and Health Care Regulation*, 2004 U. ILL. L. REV. 137, 141 (2004).

78. Thomas R. McLean & Edward P. Richards, *Health Care's "Thirty Years War": The Origins and Dissolution of Managed Care*, 60 N.Y.U. ANN. SURV. AM. L. 283, 287-88 (2004).

79. *Id.* at 288.

80. Gail B. Agrawal & Howard R. Veit, *Back to the Future: The Managed Care Revolution*, 65 LAW & CONTEMP. PROBS. 11, 30-34 (2002).

81. See McLean & Richards, *supra* note 78, at 297-98.

82. See Amy B. Monahan, *The Promise and Peril of Ownership Society Health Care Policy*, 80 TUL. L. REV. 777, 789 (2006).

83. See *id.*

84. See KAISER FAMILY FOUND. & HEALTH RESEARCH AND EDUC. TRUST, 2013 EMPLOYER HEALTH BENEFITS SURVEY 55 (2013), available at <http://kaiserfamilyfoundation.files.wordpress.com/2013/08/8465-employer-health-benefits-20131.pdf> (finding that 76% of all firms that offer health benefits offer a preferred provider organization ("PPO") plan).

plans have gained popularity.⁸⁵ Consumer-driven plans aim to give patients a financial incentive to make optimal medical consumption decisions and take better care of themselves by allowing them to share in the savings of declining unnecessary care or using lower-cost providers.⁸⁶ Because participants in consumer-driven health plans typically bear a larger percentage of their health care costs than do participants in traditional health plans, the shift from fee-for-service health plans to consumer-driven health plans has been analogized to the shift from defined benefit to defined contribution plans, as both can be characterized as shifting risk from employer to employee.⁸⁷

A. A Brief Taxonomy of Health Insurance-Related Risks

When people think about risk in the context of health insurance, they often think only of the risk of being uninsured. The risks involved are not so simple, however. To be sure, being uninsured against medical expenses is risky. Given the significant cost of medical care, and the difficulty of predicting when and to what extent an individual will need such care, being uninsured subjects an individual to dangerous levels of risk. If the individual is uninsured and needs medical care, the individual may face either a lack of care (because the provider will not provide the services without upfront payment) or financial devastation (being forced into bankruptcy when unable to pay for necessary medical services that have been provided). However, as we will see below, these risks can also affect those with health insurance.

Health insurance does not guarantee that a covered individual is fully protected against risk. Health insurance contracts do not cover every possible medical treatment nor every available medical provider. In addition, most health insurance contracts impose some type of cost sharing, meaning that the covered individual must contribute toward the cost of care through deductibles, co-payments, and co-insurance requirements. As a result, even insured individuals face both access to care risk and financial risk. If an individual's health insurance contract does not cover desired medical care, and the individual does not have the means to pay for such care directly, she may not be able to access the care.⁸⁸ In addition, even where the pro-

85. *See id.* at 145.

86. *See* Monahan, *supra* note 82, at 792.

87. *See, e.g.,* Monahan, *supra* note 82, at 843-47; Zelinsky, *supra* note 10, at 508-09.

88. One of the core purposes of health insurance is to give individuals access to care they could not otherwise afford, but this is no guarantee that all insurance contracts will provide such access. *See* Allison K. Hoffman, *Three Models of Health Insurance: The Conceptual Pluralism of the Patient Protection and Affordable Care Act*, 159 U. PA. L. REV. 1873, 1908 (2011).

vider does not demand upfront payment and the individual is therefore able to receive the desired care, the individual may still face financial devastation when the provider attempts to collect the bill.⁸⁹ Similarly, even where an insured individual has health insurance that covers the medical care received by the individual, if the cost sharing requirements are unaffordable, the individual may again face significant financial risk. In other words, even those with health insurance may have incomplete coverage and therefore be subject to the same types of risks as the uninsured.

Finally, underlying all of these risks is what I will refer to as medical risk—the risk of an individual experiencing health problems. Ideally, health insurance would help lessen this risk, by encouraging health-improving behaviors, but of course, it does not always do so. In fact, the risk of poor health may (and I emphasize may) be exacerbated by health insurance coverage that insulates individuals from the financial cost of poor health.⁹⁰ That is, adequate health insurance may have the perverse effect of discouraging individuals from safeguarding their health.⁹¹

B. How Effective Are Employers at Controlling Health Risks?

Health risks are even more complex than retirement risks. An individual saving for retirement has a relatively simple goal: to save sufficient capital to produce the income stream the individual has calculated is necessary to support the desired retirement. The planning process is imperfect and uncertain, to be sure, but not nearly as difficult as controlling risk in the health context. An individual who wants to protect against health risks is protecting against a very uncertain risk. No individual knows exactly what health services he or she will require or desire in the future, or which provider will be ideal for those uncertain services. While one might assume that this uncertainty is easily dealt with by purchasing insurance that broadly protects against all health risks, such coverage is in practice not available. Health insurance contracts do not (and arguably, cannot) spell

89. See, e.g., KAISER FAMILY FOUND., COST AND ACCESS CHALLENGES: A COMPARISON OF EXPERIENCES BETWEEN UNINSURED AND PRIVATELY INSURED ADULTS AGED 55 TO 64 WITH SENIORS ON MEDICARE 3-4 (2012), available at <http://kaiserfamilyfoundation.files.wordpress.com/2013/01/8320.pdf> (finding that 17% of privately insured individuals aged 55 to 64 reported delaying health care or having unmet health needs; 71% of those attributed the delay or unmet need to concerns over cost).

90. See, e.g., Jonathan Klick & Thomas Stratmann, *Diabetes Treatments and Moral Hazard*, 50 J. L. & ECON. 519, 524 (2007).

91. See *id.*

out precisely what will be covered and what will not be.⁹² As a result, individuals are attempting to protect against unknown risk through uncertain contracts.

In terms of controlling risk, perhaps the most significant difference between employer health plans and employer 401(k) plan is that retirement savings can be very effectively individualized. In a 401(k) plan, the employer can set defaults that are appropriate for most participants, while allowing any individual that desires a different savings strategy to make a different decision. That dynamic is absent in employer health plans, where, at best, an employee may have a choice from a small menu of plan options. While there may be some plan choice, generally there is no ability to customize a plan. If an employer offers plans that all have a \$1,000 deductible, and an employee cannot afford \$1,000 in medical expenses, there is no way for the employee to elect a lower deductible within the employer plan, nor can she easily access alternative private coverage in most states. In other words, for health plans it is not defaults that matter. It is the plan design that matters. Employers must get this right or their employees could be subject to significant financial, access, and medical risks.

The fact that health needs and preferences are so individualized makes it difficult to evaluate how well employers protect employees from health risks. It is therefore helpful to think through how employers make decisions in the health plan context. One health economist has offered the following simplified overview of the employer-employee dynamic when it comes to health plans, “each employer picks the policy the ‘decisive worker’ in their firm would want, given the full net (of tax-subsidy) cost of the benefit; workers then make choices across firms” in order to find an employer that provides the desired health plan and compensation package.⁹³ Assuming this model is generally accurate, firms would design plans to appeal to that elusive “decisive worker,” and prospective employees who find the health plan, in combination with all other aspects of the job and compensation, unattractive will seek work elsewhere. The result, even if we assume full information regarding health plans, is that employer plans are unlikely to satisfy all employee preferences, and dissatisfied employees may not necessarily switch employers to compensate, as they must take into account all other aspects of the job and compensation package. The theory therefore presents the possibility that labor market pressures will not automatically

92. See CLARK C. HAVIGHURST, HEALTH CARE CHOICES 14-15 (1995) (explaining that “under the health care contract we use today, the nature, quality, and precise content of services to be provided in the future are generally not defined to any appreciable degree in the contract itself”).

93. Mark V. Pauly, *Making Sense of a Complex System: Empirical Studies of Employment-Based Health Insurance*, 1 INT’L J. HEALTH CARE FIN. & ECON. 333, 334 (2001).

result in employer health plans that adequately protect employees from the risks identified.

Relatively few empirical studies examine how this economic model plays out in practice.⁹⁴ Instead, we are left to infer how well employers do at protecting employees against risk by examining various second-best indicators. First, among all firms in private industry, just 60% offered health benefits to employees in 2012,⁹⁵ leaving a large number of employees potentially subject to each of the health insurance risks. Only 72% of those offered medical coverage accept it, resulting in 51% of private industry workers covered by their employer's plan.⁹⁶ This relatively low acceptance rate suggests that employer plans may not satisfy the preferences of employees, but that is a tentative conclusion at best, and tells us little about why individuals decline offered insurance. Surveys of employees who remain uninsured after declining employer-provided coverage cite cost as the primary reason for declining coverage.⁹⁷ Very few respondents indicated that the reason they decline insurance was that they did not need it.⁹⁸ These findings tentatively suggest that employer coverage does not satisfy all employees' preferences – hardly a surprising finding – but also that those who remain uninsured may face significant financial and access risks as a result. After all, if subsidized premiums are unaffordable, it is highly likely that actual medical care would be unaffordable as well.

Employee preferences are easier to satisfy where the employer offers employees a choice of plans. However, 82% of firms that offer health benefits offer employees only a single plan, although over half of all workers have a choice of health plans.⁹⁹ This results in a sizeable portion of the employee population having only a single “take it or leave it” health plan

94. See, e.g., M. Kate Bundorf, *Employee Demand for Health Insurance and Employer Health Plan Choices*, 21 J. HEALTH ECON. 65 (2002); Michael Chernew et al., *Quality and Employers' Choice of Health Plans*, 23 J. HEALTH ECON. 471 (2004) (presenting some evidence that employers are responsive to employee health plan preferences).

95. DEP'T OF LABOR, NATIONAL COMPENSATION SURVEY tbl.1 (Mar. 2012), available at <http://www.bls.gov/ncs/ebs/benefits/2012/ownership/private/table01a.pdf>.

96. *Id.* at tbl.9. Note that some of the workers who decline coverage from their own employer may in fact be covered by a spouse's employer plan. And because employer plans also offer coverage to workers' families, the total number of non-elderly individuals covered by employer plans exceeds 55%. THE KAISER COMM'N ON MEDICAID AND THE UNINSURED, *THE UNINSURED: A PRIMER 1* (2013).

97. See, e.g., David M. Cutler, *Employee Costs and the Decline in Health Insurance Coverage*, 6 FRONTIERS IN HEALTH POL'Y RES. 27, 35 (2003). But see Alan C. Monheit & Jessica Primoff Vistnes, *Health Insurance Enrollment Decisions: Preferences for Coverage, Worker Sorting, and Insurance Take Up* (Nat'l Bureau of Econ. Research Working Paper No. 12429, 2006) (suggesting that workers that decline coverage may have weak or uncertain demand for coverage).

98. Cutler, *supra* note 97, at 35.

99. KAISER FAMILY FOUND. & HEALTH RESEARCH AND EDUC. TRUST, *supra* note 84, at 55.

option, and increases the likelihood that some employees will continue to face health-insurance related risks even if they have coverage.

It is also important to note that employer plans often impose significant financial burdens on participants. Although premiums tend to be heavily subsidized by employers,¹⁰⁰ out-of-pocket cost sharing—in the form of deductibles, co-payments and co-insurance—can be significant.¹⁰¹ For example, while some employer plans, particularly HMOs, do not impose an annual deductible,¹⁰² among those plans that do, the average deductible for single coverage ranges from \$691 in HMO plans to \$2,086 in high-deductible health plans.¹⁰³ These numbers are significantly higher for family coverage.¹⁰⁴ High out-of-pocket costs can and do cause financial distress and, in some cases, bankruptcy,¹⁰⁵ particularly for those in low-income groups. In addition, the out-of-pocket cost of care, even for those with insurance, may be significant enough that insured individuals either delay or do not receive needed medical care.¹⁰⁶ One survey found that 17% of individuals with private health insurance coverage either delayed health care or did not receive needed health care, with the majority of such individuals citing cost as the reason for the delayed or unmet care need.¹⁰⁷ While not definitive, these findings suggest significant risk is present even where an employee receives coverage through an employer.

One final indicator of how well employers do at designing health plans that protect employees is employee satisfaction surveys – again an imperfect barometer. One recent survey found that employee satisfaction is relatively low, but varies significantly by plan type. For example, 57% of participants in traditional employer health plans were extremely or very satisfied with their plan, while that number was 37% for participants in a

100. *Id.* at 67 (finding that employees were, on average, required to pay only 18% of the premium cost for single coverage, with the employer paying the remaining 82%).

101. *See id.*, at 96-138.

102. *Id.* at 96.

103. *Id.* at 108.

104. *Id.* at 116 (finding average family coverage deductibles of \$1,743 for HMO plans and \$4,079 for high-deductible health plans).

105. The extent to which medical expenses contribute to or causes bankruptcy is much debated. *See generally* David U. Himmelstein et al., *Medical Bankruptcy in the United States, 2007: Results of a National Study*, 122 AM. J. MED. 741 (2009); David Dranove & Michael L. Millenson, *Medical Bankruptcy: Myth Versus Fact*, 25 HEALTH AFF. W74 (2006); Melissa B. Jacoby & Mirya Holman, *Managing Medical Bills on the Brink of Bankruptcy*, 10 YALE J. HEALTH POL'Y, L. & ETHICS 239 (2010); Amy Y. Landry & Robert J. Landry, III, *Medical Bankruptcy Reform: A Fallacy of Composition*, 19 AM. BANKR. INST. L. REV. 151 (2011).

106. *See, e.g.*, KAISER FAMILY FOUND., COST AND ACCESS CHALLENGES, *supra* note 89, at 3-4 (finding that 17% of privately insured individuals aged 55 to 64 reported delaying health care or having unmet health needs; 71% of those attributed the delay or unmet need to concerns over cost).

107. *Id.* at 3-4.

high-deductible plan without a health savings account.¹⁰⁸ The percentage of individuals who report being extremely or very likely to stay with their current plan if they had the opportunity to change tracks very closely to the satisfaction numbers just given.¹⁰⁹ While it is clear that a significant number of employees are not satisfied with the coverage they receive from their employer, it is difficult to conclude from these data whether employer plans adequately protect employees from the various health risks. Employees may be unsatisfied with their health plans because they leave them vulnerable, or they may be dissatisfied simply because health plans and health care is expensive. What is easier to conclude is that for most individuals, if their employer plan is inadequate, they are unlikely to find better coverage elsewhere.

One area where employers appear to be doing fairly well is with respect to helping employees control actual medical risks. Health insurance is often theorized to increase the likelihood of individuals developing medical problems, simply because the financial cost of the medical problem is borne by the insurer, not the individual.¹¹⁰ Employers, however, often have an interest in minimizing employee medical risks, not only to control costs, but also to reduce absenteeism. Large employers have been in the vanguard with respect to health plan designs aimed to encourage the use of highly-effective care and to discourage the use of less-effective care, through what is known as value-based insurance design.¹¹¹ While this innovation has not yet become commonly adopted, having employers engage in such experimentation allows others to learn about optimal plan design. One innovation that has become widespread among employers is the use of wellness plans to promote employee health. Of those firms offering health insurance to employees, 63% offer some form of wellness plan, with large firms being much more likely to offer such plans than are small firms.¹¹² While there is concern that wellness plans may end up discriminating against the sick and low-income, studies have found that employer wellness plans can reduce

108. Paul Fronstin, *Satisfaction with Health Coverage and Care: Findings from the 2011 EBRI/MGA Consumer Engagement in Health Care Survey*, 33 EMP. BENEFIT RES. INST. NOTES 2, 4 (Aug. 2012), available at <http://www.ebri.org/pdf/notespdf/Notes.Aug12.Final-CEHCS.pdf> (note that the survey includes privately-insured individuals, which includes both individuals who purchase coverage through an employer, and those that purchase on the individual market).

109. *Id.* at 9 (58% in traditional plans, 34% in high-deductible plans without a health savings account, and 49% in high-deductible plans with a health savings account).

110. See, e.g., Mark V. Pauly, *The Economics of Moral Hazard: Comment*, 58 AMER. ECON. REV. 531 (1968).

111. See, e.g., Michael E. Chernew et al., *Value-Based Insurance Design*, 26 HEALTH AFF. w195, w195-w196 (2007).

112. KAISER FAMILY FOUND. & HEALTH RESEARCH AND EDUC. TRUST, *supra* note 84, at 201.

both health care costs and absenteeism,¹¹³ providing at least superficial evidence that employers may, in this area, be meaningfully mitigating health risks.

III. WHY DON'T EMPLOYERS DO A BETTER JOB PROTECTING EMPLOYEES' HEALTH AND RETIREMENT SECURITY?

The reasons that employers fail to provide optimal defined contribution plans and health plans are likely numerous. First, many employers are simply ill-equipped for the complex task of designing and implementing health and retirement plans. While large corporations easily and often expertly handle these complex design decisions, smaller firms simply do not have the expertise or resources to adopt a plan, let alone an optimal plan. Even for those employers that make the decision and devote the resources necessary to sponsor a plan, the employers do not necessarily have the right incentives when it comes to structuring employee benefit plans. Given how often Americans change jobs,¹¹⁴ employers do not necessarily need to appeal to the long-term interests of their employees in order to attract and retain desired workers. Moreover, most employees likely do not pay enough attention to the intricacies of employee benefit plan details to create any type of labor market pressure to change employer behavior. Employees are likely to focus on highly salient features, such as whether an employer offers a retirement or health plan at all, whether the retirement plan offers a matching contribution, and what premiums and out-of-pocket expenses are in the health plan. Employees are unlikely to scrutinize less noticeable plan features, like whether the retirement plan utilizes automatic enrollment or quality investments, and whether the health plan covers specific treatments or utilizes quality providers.

In practice, employers likely differ significantly in their ability to provide risk-reducing employee benefit plans. The largest employers, with large and sophisticated human resources departments that work with expert consultants, are certainly more likely to offer benefit plans in the first place, but also to thoughtfully design their plans in ways that minimize risk. For example, these employers can pay attention to employee de-

113. Katherine Baicker et. al, *Workplace Wellness Programs Can Generate Savings*, 29 HEALTH AFF. 304, 307 (2010) (presenting the results of a meta-analysis finding that every \$1 spent on wellness programs produces a reduction of \$3.27 in health care costs and \$2.73 in absenteeism costs).

114. See, e.g., U.S. DEPT. OF LABOR, BUREAU OF LABOR STATISTICS, NUMBER OF JOBS HELD, LABOR MARKET ACTIVITY, AND EARNINGS GROWTH AMONG THE YOUNGEST BABY BOOMERS: RESULTS FROM A LONGITUDINAL SURVEY (July 25, 2012), available at <http://www.bls.gov/news.release/pdf/nlsoy.pdf> (finding that young baby boomers held, on average, 11.3 jobs between the ages of 18 and 46).

mographics when deciding the level of cost sharing that is appropriate for their employee population, in order to ensure that health plan deductibles and co-insurance levels do not prevent employees from accessing needed care. They can also structure sophisticated wellness plans, often using their own health plan claims data, to meaningfully improve employee health.

Smaller employers live in a much different world. These employers often have limited human resource departments that may not have a dedicated benefits staff. When it comes to establishing a retirement plan, these employers typically adopt what is known as a “prototype” 401(k) plan – a standard plan offered by a plan administrator. To establish the plan, the employer simply signs an adoption agreement that requires the employer to check off plan design features on a checklist a few pages in length. These plans both constrain employer choices and do not typically involve detailed plan design study on the part of the employer. In addition, many of the plan design choices an employer makes end up being driven by cost. An employer may select a 401(k) plan administrator, and 401(k) plan investment options based on which company will provide them with the lowest out-of-pocket costs, not which will deliver the most retirement security to participants.¹¹⁵ And because participants tend not to pay attention to these plan details, employers do not feel much pressure to make different choices. While regulators could lessen or eliminate these risks by directly regulating plan structure, they have not yet chosen to do so.

When it comes to health plans, small employers often rely on an insurance broker to suggest plans for them.¹¹⁶ Because the product the employer is purchasing is an off-the-shelf product, limited design choices can be made, and again it is unlikely that the employer would undertake a detailed plan design study to inform their available choices. Employers are unlikely to change this method of selecting health plans, given that employees are likely to focus primarily on premium level and cost-sharing requirements.¹¹⁷

115. For a discussion of these issues, see Bullard, *supra* note 48.

116. See Leslie Jackson Conwell, *The Role of Health Insurance Brokers: Providing Small Employers with a Helping Hand*, 57 HEALTH SYS. CHANGE ISSUE BRIEF 1, 2 (2002), available at <http://www.hschange.com/CONTENT/480/480.pdf>.

117. This is not to suggest that small employers are unsophisticated or unresponsive to market pressures, but rather that in this case there is insufficient market pressure for these employers to change their behavior. For a discussion of strategic small employer decision-making in the health plan context, see generally Amy B. Monahan & Daniel Schwarcz, *Saving Small-Employer Health Insurance*, 98 IOWA L. REV. 1935 (2013).

IV. USING LAW TO MITIGATE EMPLOYERS AS RISKS

A. Retirement Risks

Given the rather stark evidence that employers in many cases fail to offer their employees any retirement plan, or offer them a plan that is not designed to protect against retirement savings risks, there is a significant role for law to play in mitigating employers and their choices as sources of retirement savings risks to their employees. Command and control regulation would offer the most straightforward method of addressing the risks resulting from poor employer decisions. Congress could simply require employers to offer a 401(k) plan, and require that plan to meet very specific parameters. Of course, it is highly unlikely that Congress would do so. There are real costs to businesses to establish and maintain a retirement plan, and there likely is not the political will to force employers to do so. Nevertheless, while we may be unwilling to require employers to provide retirement savings plan, we could change federal law to make tax-favored retirement savings vehicles universally available.¹¹⁸

There is also much room for improvement in how we regulate the 401(k) plans that already exist. When it comes to participant-directed retirement savings, we have strong evidence of suboptimal decision-making on the part of participants, as well as evidence that merely changing the defaults to favor plan participation at an adequate rate dramatically improves savings. We also know that the investment menu and investment fees are critical to retirement savings success. Requiring employers to adopt plan designs that default participants into appropriate savings rates, appropriate investments, and appropriate distribution forms will likely go a long way toward improving retirement security for many Americans. And while the default choices might not be optimal for everyone, the fact that they are merely defaults should lessen their impact on those who make rational decisions that differ from the default. The retirement plan world has changed dramatically in the last several decades. It is time for the law to catch up.

B. Health Risks

Because health risks vary so significantly among individuals, it is harder to come up with a legal prescription for health risks. Law could require employers to provide health plans, could regulate the type of health

118. For a discussion of this possibility, see Amy B. Monahan, *An Affordable Care Act for Retirement Plans?*, 20 CONN. INS. L. J. (forthcoming 2014).

plan to be offered, and could require the use of incentives to promote healthy behavior. But unlike retirement savings, which has fairly universal rules-of-thumb, and an easy way to accommodate individual choice, it is hard to come up with blanket recommendations with respect to controlling health risks. The ACA, however, provides a unique example of using law to mitigate employer choices that may subject employees to significant health risks, in a manner that largely preserves individual choice.

First, the ACA provides a financial incentive for most employers to offer health insurance to their employees. For various reasons, this so-called employer mandate is unlikely to cause many employers that had not previously provided a health plan to begin doing so. However, the ACA does greatly impact the employer market by, for the first time, offering a viable alternative to such coverage. Beginning in 2014, if an individual's employer either does not offer a plan, or offers a plan does not meet the employee's preferences, she should be able to select from a wide range of coverage on the health insurance exchange in her state. A variety of premiums, cost-sharing levels and networks should be available to allow an individual to control adequately many of the risks described above.

An open question is whether these newly created individual markets will in reality function to allow individuals to better control their health risks. While it is true that we would expect a wide variety of plans to be available, individuals may still struggle with the complex decision of choosing the appropriate plan.¹¹⁹ Not only does choosing a health plan involve a large number of variables, health risks themselves are unpredictable and many factors such as quality are difficult for consumers to observe.¹²⁰ However, the ACA does contain some provisions that should improve consumer decision-making. The ACA requires all plans sold in the individual and small group markets to cover the same minimum package of benefits (referred to as "essential health benefits"),¹²¹ thus eliminating potentially significant variation among plans with respect to what medical services they cover. The ACA also requires all plans sold on the individual market to provide a concise "summary of benefits and coverage" that contains basic coverage terms as well as examples of how various common expenses would be covered by the plan. These uniform coverage provisions and consumer-friendly and concise disclosures should simplify a consumer's plan decision-making.

119. See Russell B. Korobkin, *Comparative Effectiveness Research as Choice Architecture: The Behavioral Law and Economics Solution to the Health Care Cost Crisis*, 112 MICH. L. REV. 523, 527 (2013).

120. See *id.*

121. Patient Protection and Affordable Care Act, 42 U.S.C. § 18022 (2010).

The ACA is not perfect, however. Plans offered in the individual market are unlikely to offer a wide choice with respect to the medical services covered by the plans. While all plans will be required to offer “essential health benefits,” it is unlikely that any plans will voluntarily offer benefits in excess of those mandated essential benefits. As a result, if an individual requires medical treatment that is not considered an essential health benefit, she is likely to find that insurance coverage for that treatment is not available, thereby continuing to subject her to significant risk.

Financial shock risks should be able to be better controlled once the ACA’s reforms take effect in 2014, because individuals will have the ability to choose plans with varying levels of cost sharing. For example, if an employer offered an employee a single health plan option with a deductible of \$2,000 that was unaffordable for that employee, he or she will be able to go to the exchange and find a plan with a significantly lower deductible. This assumes, of course, that the individual will be able to afford the premium associated with the lower-deductible plan.

While the ACA contains subsidies for low- and moderate-income individuals to purchase health insurance,¹²² affordability will undoubtedly remain an issue for some individuals. As a result, even if a plan were available that would adequately protect an individual against various health risks, that individual may be unable to afford such coverage. Compounding this problem is the fact that an individual can only purchase health insurance coverage on a tax-free basis through an employer.¹²³ If an individual must rely on the exchange to receive adequate health insurance coverage, she would have to pay for that coverage with after-tax dollars in most cases.

One risk that the ACA arguably will not help mitigate is medical risk. This is one area where employers may have a distinct advantage over insurers. Given that an individual may easily change insurance carriers every year, insurers likely do not have a significant financial motivation to create rewards for policyholders who engage in health-promoting behavior that may not pay off until years in the future. Employers, on the other hand, are likely to have longer time horizons to work with, and may therefore have an incentive to create long-term wellness programs aimed at improving employee health. Employers are also likely to benefit from such health improvements in ways other than reducing direct health care costs, thus further encouraging the formation of wellness programs. These programs

122. Patient Protection and Affordable Care Act, Pub. L. No. 111-148 § 1401; I.R.C. § 36B (2010).

123. See I.R.C. § 106 (West. 2012).

are not without their downsides – they can in the worst cases act as a form of discrimination against the sick or poor – but well-structured programs can provide a meaningful improvement in controlling medical risks.¹²⁴

It may be tempting to conclude that many employers should simply get out of the employee health care business once the ACA's major reforms take effect in 2014, but that is not necessarily the case. Employers still have an important role to play in helping employees control health risks. Employers, if they are thoughtful about health plan design, may be able to put together a plan that better meets the needs of its employees than do available plans on the individual market. In addition, employers are able to facilitate pre-tax purchasing of insurance, which can help make health coverage more affordable for many individuals. And finally, an employer has a different relationship to covered employees than does an insurance company. Employers have longer-term interests and an interest in keeping employees healthy that extends beyond mere direct health expenditures. We would do well to encourage employers to capitalize on that interest to create health-promoting incentives. But the good news is that, regardless of what employers do post-ACA, employees will no longer be put at significant risk if their employer fails to offer a plan, or offers a plan that fails to meet the employees' needs. Indeed, individual plans in the state exchanges will effectively act as competition against employer plans. Well-designed employer plans should continue to enjoy success with employees, while poorly designed plans are likely to see their enrollment dwindle as employees move to more attractive options. There is tremendous potential for the ACA to make meaningful changes to how health insurance is provided in this country, but we must continue to monitor health risks and be willing to make changes to the law as circumstances require.

CONCLUSION

The ACA will fundamentally change the role of employers in ensuring health security for most Americans. It will do so not by removing employers from their historic role, but rather by providing, for the first time, a real option for individuals whose employers do not offer attractive, affordable coverage. No longer will employees be solely dependent on the luck of

124. See, e.g., Jill R. Horwitz et al., *Wellness Incentives in the Workplace: Cost Savings Through Cost Shifting to Unhealthy Workers*, 32 HEALTH AFF. 468, 469 (2013) (finding "little evidence that such programs can easily save costs through health improvement without being discriminatory"); Baicker et al., *supra* note 113, at 304 (finding that "that medical costs fall by about \$3.27 for every dollar spent on wellness programs and that absenteeism costs fall by about \$2.73 for every dollar spent").

having a sophisticated employer that thoughtfully designs health plan coverage options.

We still have work to do in this regard when it comes to retirement plans. If an employer fails to offer a retirement plan, or offers a retirement plan that has poor investment choices, high fees, or inadequate defaults, an employee typically lacks non-employer alternatives. The law can and should do a much better job of controlling employers as risks in the retirement plan context.