

# Obtaining Full Disability Income Protection for Employees—

## How To Make Your Plan Succeed and Increase Coverage at Little or NO Extra Cost to the Company

By Connie Golleher

As companies battle for top talent, they are also looking at controlling the soaring costs of benefits. Finding the right balance is the challenge.

One way of boosting benefits with little or no cost to the company is to sponsor insurance plans that the employees pay for themselves.

Because of the company's endorsement, they receive a discount and a better policy from the insurer. It can be a win for everyone.

The most valuable asset an employee has is the ability to earn an income - and employees are realizing that if they are unable to work they risk lifestyle changes unless they have adequate income-replacement benefits. The greater the income, the greater the potential loss if one is disabled for an extended period of time. (The majority of long-term disabilities are not due to accidents but illnesses such as heart disease and cancer.) Employees want to secure the maximum benefit, for as little cost as possible, in the easiest manner. Most employees do not want to leave it up to chance and want to take the necessary steps to insure their future.

Disability insurance is the key, but is a group long-term disability (LTD) insurance plan sufficient? Group LTD is the starting point for income

protection for employees. But no group LTD plan alone can provide the full solution for highly paid executives and employees that are underinsured. It takes a combination of group LTD plus *individual* disability policies to provide full coverage, and the best way to secure these policies is through an employer-sponsored plan.

Group LTD is typically limited to covering a maximum of 60% of base salary up to \$20,000 to \$25,000 a month (or \$30,000 to 35,000 at very large companies). To exceed the \$25,000 maximum, carriers are looking to have a significant risk spread to justify higher plan maximums. Insurers are basing their 60% limit on salary only, as group LTD does not replace any bonus money or 401(k) matches—and those extras can account for half of an employee's income. Another disadvantage: if the firm pays the premium, any payments received could be 100% taxable to the employee, like salary.

Designed for the masses, group coverage is economically attractive, employer-owned and has a variable rate structure. The premiums are inherently volatile, and companies should be concerned about the impact of just one claim of a highly compensated executive, which can



**Connie Golleher**, insurance expert, is chief operating officer of The Holleman Companies, an insurance-advisory firm in Chevy Chase, MD. She can be reached at [connie@hollemanco.com](mailto:connie@hollemanco.com) or 301-656-8689 ext. 305. [www.hollemanco.com](http://www.hollemanco.com)

increase the rates significantly. These “shock” claims, as they referred to in the industry, are changing how companies and insurance carriers are approaching rates and product offerings.

For example, a company with approximately 60 top executives, a \$20,000 per month group LTD benefit, and only one claim worth \$10,000 a month of benefits would cause a loss ratio of approximately 350% to the carrier, and that carrier would look to increase the LTD rates significantly at the plan renewal.

To meet plan objectives, level off potential shock claims, and stabilize rates, companies are utilizing the integration of group LTD and non-cancellable individual disability income policies (IDI). Such policies are customized, value-added,

individually owned, with rates that are level. By integrating the plans, the company is transferring the risk to an individual platform with level premiums. There are two primary integration platforms: (1) “less LTD,” which has the group LTD as the base coverage and IDI supplemental on top, and (2) “reverse combo,” which has IDI as the base coverage and group LTD on top. Both platforms can offer pros and cons and each should be looked at when contemplating adding the IDI component.

Employees, can of course, buy an IDI policy without help from their employer. But buying an IDI policy on one’s own is difficult because getting insured requires a medical exam, lab work, answering many medical history questions, and financial justification and verification. Companies can help employees get a better deal by purchasing or sponsoring supplemental IDI policies. Sponsoring means that the employer endorses the plan, lets its employees know about the opportunity, provides meeting space, and agrees to have the premiums for the coverage payroll-deducted. In return for getting the chance to sell multiple policies, the insurance company provides a better deal. Besides giving the company an attractive benefit at little to no cost to the company, other advantages of employee-sponsored individual policies can include:

- **Guaranteed standard issue.** A primary reason that companies consider purchasing or endorsing a supplemental IDI plan is that there are no medical underwriting or medical-exam requirements. There are just a few questions: Has the employee has been working the past 180 days? Is there an existing disability? What is his/her smoking

status? *Everyone who’s not currently disabled is guaranteed to qualify.*

- **Contract language that can protect an employee’s specialty.** This is an important component when determining LTD and/or IDI coverage. The definition of disability varies with insurance carriers and with different types of specialties. The “own occupation” definition of disability does not always cover an employee’s skill set.
- **Coverage of more of the employees’ income** because other compensation, such as bonuses in addition to base salary, can be used to secure a total compensation benefit amount. When you put both group and individual plans together, you can replace much more income than with either alone.
- **Discounted rates up to 40%.**
- **Nontaxable benefit payments.**
- **Catastrophic benefits** that can replace up to 100% of income for the most serious types of disabilities.
- **Portable coverage.** The employee can keep the individual policy when he or she leaves the company.
- **The ability to convert the disability policy to a long-term-care policy.**
- **Noncancelable policy—rates can’t increase!** The premiums can never be increased above the amount shown in the policy, and benefits cannot be reduced as long as premiums are paid on time. This important feature differs from coverage that is merely guaranteed renewable. Guaranteed renewable says that you have the right to renew the policy with the same benefits, but the insurer can

## DISABILITY FACTS

- A disability can happen at any moment and at any point in your life:
- At age 30 a man is seven times more likely to become disabled than to die.
- At age 30 a woman is four times more likely to become disabled than to die.
- At age 40 there’s a 43% chance you’ll have a long-term disability before turning 65.
- At age 50 the odds of becoming disabled are more than double the risk of dying.

*Source: JHA Disability Fact Book, Fourth Edition, 2006*

increase premiums, as long as they are increased for all other policyholders in the same class, having the same characteristics. Although the initial premiums for guaranteed renewable policies may be lower initially than for noncancelable policies, they can go up over time.

The marketplace for these IDI policies is small, with only a handful of carriers offering a truly competitive guaranteed standard issue contract. Because the insurance policy varies widely based on the insurer and the state in which it will be issued, it is always important to talk with a financial professional.

While combining group and individual policies is adequate for most employees, insuring the top earners in the company is more challenging. Generally, reverse discrimination begins to take place starting at \$600,000. The maximum monthly benefit available to executives through normal LTD and IDI channels is \$30,000 per month for small to medium size companies; \$50,00 for larger companies, but usually only when the policies are paid for 100% by the company.

However, there are insurance companies that specialize in high-income earners, and they will participate up to 75% of earned income, with issue limits as high as \$200,000 per month. Earned income can include base salary, bonus, commissions, and pension contributions. Stock options and grants are not covered due to the potential variability in realized profits. With seven-figure incomes, the maximum benefit at 75% of income is a large number with an equally impressive premium.

Understanding the policy provisions, contract language, and process thoroughly will ensure an easy implementation of this value-added benefit. The basic steps to implementation are:

- Choose the insurance agent/financial professional to work with. Often, a group benefits insurance agent is not focused on the individual plans and has limited expertise with the product provisions.
- The agent you choose should take a redacted (no names or Social Security numbers) census to the marketplace to determine the strongest and most competitive offer for the company. Quotes are tailor-fitted to each individual

## DETERMINING YOUR EARNING POWER

Formula:  $(65 - \text{Your Current Age}) \times \text{annual salary}$

### *Example*

$65 - 47 = 18 \text{ years} \times \$300,000 \text{ (annual salary)} =$   
 $\$5,400,000 \text{ (Future earning potential)}$

company, so requests for quotes will vary.

- Once it's been decided which insurer is best suited for the firm and the enrollment timeline is determined, the communication to the employees begins. All agents and insurers have communication pieces that can be tweaked to fit any company's specific needs. The first step is a pre-enrollment communication from the company to the employees. This document announces the company's endorsement of the plan and reviews the attributes of the new benefit. Next, personalized enrollment kits are produced and distributed by the insurer and agent. Depending on insurer, enrollment can be handled face-to-face, over the phone, by Internet access, in group meetings, or a combination of all these. Employees usually prefer a face-to-face meeting with a representative. At these meetings they can get all their questions answered. Don't skimp on any aspects of the enrollment process: it's the key to getting good participation. The agent will do virtually all the work, but the company has to provide a clear endorsement and the time and space for the agent to do a great job with enrollment.
- Policies are issued and distributed to the employees.

There are a few trends companies should note and watch for:

- In recent months insurance companies have been seeing an increase in the desire to increase benefit maximums. Companies are benchmarking the total compensation package with the competition.
- Companies are electing full mental and nervous benefits. For instance, one insurer reports that 25.7% of the claims on one insurance carrier's IDI lawyer block were related to mental/nervous.
- Carriers are reducing the rates on individual products due to the favorable experience over the past few years.
- Companies are transferring the risk and stabilizing cost by shifting the cost of individual policy to the employees.

Crafting a comprehensive disability income-protection plan for employees takes planning and thought. But the market today is more favorable than ever. By choosing the right combination of group and individual policies, your company can get the most cost-effective, attractive plan for its needs.