

Individual Disability Insurance Can Fill a Gap in Employer Benefit Plans

By Connie Golleher

The most valuable asset an organization has is its employees, and the most valuable asset the employees have is the ability to earn an income. Combine these two assets, and a company realizes that providing income-protection benefits for employees becomes a key element of the employer's benefit package. However, current economic factors as well as workforce trends make providing competitive benefits that offer value to both your organization and employees challenging.

With the uncertainties in the economy and the workplace, employees are most concerned about their continued ability to earn an income. Therefore, employers can improve their ability to attract and retain skilled talent by trying to address the need for income protection. Most organizations provide a core group long-term disability (LTD) benefit that covers the employee's base salary, typically up to 60 percent. Do your employees understand that the benefit is likely to be taxable should they begin to receive it? Is what you are offering your employees adequate? One way to boost income-protection benefits with little or no cost to the organization is to sponsor individual

disability insurance (IDI) plans that employees pay for themselves. These IDI plans are customized, value added, individually owned by employees, and have rates that are level.

CALCULATING THE BENEFITS

As an example, suppose an employee gets injured off the job and is unable to work for three or more months. The following scenarios show how the addition of an IDI plan can help the employee. Note that the industry standard in calculating benefits is to protect up to 60 percent of income under a group LTD plan and up to an additional 7 percent when incorporating an IDI plan.

Traditional Plan

Employee earns \$100,000

Employer-paid group LTD benefit is 60 percent, up to \$5,000 monthly-benefit cap

60 percent of \$100,000 income = \$5,000 per month

Group LTD benefit: \$5,000 per month

If the employee is disabled, due to sickness or accident and is unable to work, the group LTD benefit would be \$5,000, which is taxable.



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Addition of a Sponsored IDI Plan

Using the same circumstances as above, an employee earns \$100,000 and has the same group LTD benefit of \$5,000.

However, by adding an IDI policy, the employee would get an additional monthly benefit of \$583, for a total monthly benefit of \$5,583 (\$67,000 annually).

Greater Impact on Higher Earners

Higher-earning employees (those who are earning over \$100,000) end up having a smaller percentage of income protected under a traditional group LTD plan than employees earning less than that, as is demonstrated below.

Traditional Plan

Employee earns \$200,000

Employer-paid group LTD benefit is 60 percent, up to \$5,000 monthly-benefit cap

60 percent of \$200,000 salary = \$10,000 per month

Group LTD benefit: \$5,000 per month

If the employee is disabled, due to sickness or accident and is unable to work, the group LTD benefit would be capped at \$5,000, which is taxable. However, for the higher-income earner, this benefit amount represents only 30 percent of income protection as compared with 60 percent offered to lower-earning employees.

Addition of a Sponsored IDI Plan

Assume the same higher-income scenario, where the employee earns \$200,000, the employer-paid group LTD benefit is 60 percent up to a \$5,000 monthly benefit cap.

By adding an individual policy, the employee would get an additional monthly benefit of \$6,000, for a total monthly benefit of \$11,000. With the IDI, the higher-earning employee is able to protect more of his or her income.

Employer Advantages

The employer sponsored IDI income-protection plan can meet a number of objectives for the employer as well:

- Level off potential shock claims for the employer. Group LTD premiums are inherently volatile and can be difficult to predict and manage over time because the rates are not guaranteed, and one claim can dramatically increase the group LTD cost.

Exhibit 1. Income-Protection Plan Features

Group LTD Features	Individual Income-Protection Features
<ul style="list-style-type: none">• affordable economics of scale• variable rate structure• employer-owned policy, part of value benefit package• no medical underwriting for newly eligible employees	<ul style="list-style-type: none">• level premiums• employee-owned policy• employee determines need and chooses level of protection• under current tax laws, nontaxable benefit when premium paid by employee• portable• no medical underwriting
<p style="text-align: center;">Integrated Disability-Plan Advantages</p> <ul style="list-style-type: none">• can reduce risk exposure from the impact of high-income disability claims• enhances benefit options for employees• can be employer or employee paid• additional protection option can help attract and retain key employees	

- Stabilize group LTD rates. By integrating the IDI coverage, which has a level premium structure, an organization can reduce its exposure to group LTD rate increases.
- Provide a value-added benefit to keep employers competitive. Employees are provided a platform to purchase a product otherwise not available to them in the open marketplace. The IDI policy covers more of total compensation, is portable, and has level premiums. Such a benefit becomes a valuable addition to an employer's overall compensation package.

INTEGRATING LONG-TERM DISABILITY COVERAGE

Although many organizations are looking to enhance benefit plans, they are also looking to reduce risk from their current program. The integrated approach is a unique way to greatly enhance the benefit for employees while building a risk-sharing component into the group LTD plan that may help to

stabilize the overall plan against future pricing volatility.

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

Group LTD plans are a very cost-effective way to provide a basic level of income protection to all employees. Individual income protection plans provide features and benefits that complement the base group plan. Combining these platforms can result in a more beneficial and comprehensive long-Term income protection program.

The option that reduces the percentage of salary covered by the

group plan uses the money saved by the reduction to fund the addition of the individual policies. This approach is an incentive to the employer because the individual policies have level premiums and are noncancelable. It allows the employer to budget because the cost does not increase. The reverse option uses the IDI as the base coverage and supplements with the group LTD on top. Both platforms can offer pros and cons, and each should be looked at when contemplating adding the IDI component.

The features of the group LTD, IDI, and integrated plans are listed in Exhibit 1. The options available are described in greater detail below.

Buying Their Own Policies

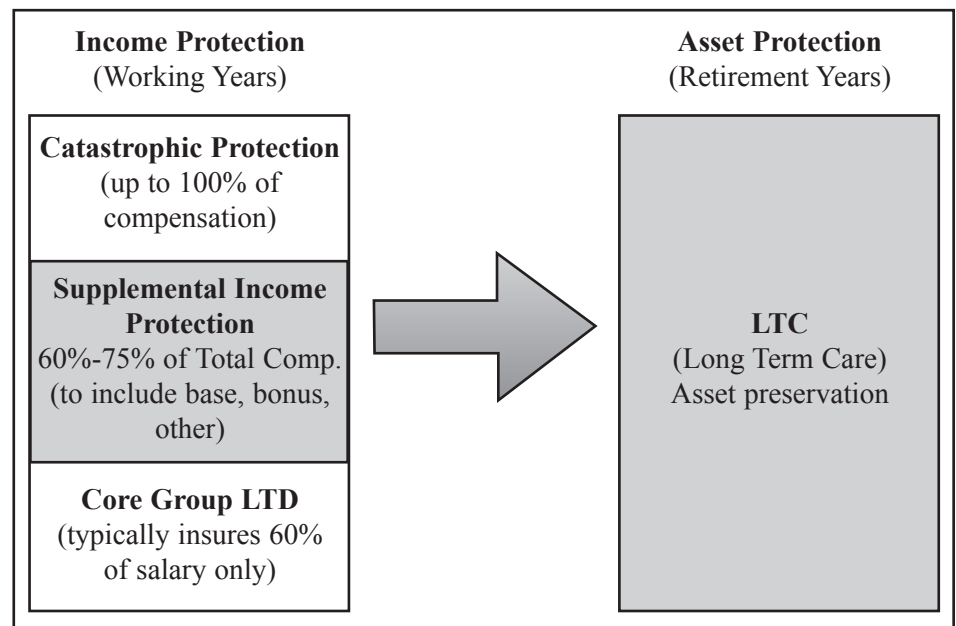
Employees can, of course, buy an IDI policy without help from their employers. But this can be difficult because getting insured will require a medical exam, lab work, answering many medical questions, and financial justification and verification. Employers can help employees get a better deal by sponsoring a supplemental IDI plan. Sponsoring means that the employer endorses the plan, lets its employees know about the opportunity, provides meeting space, and agrees to have premiums paid through payroll deductions. In return for getting the chance to sell multiple policies, the insurance company provides a better deal. Besides giving the employees an attractive benefit at little to no cost to the organization, other advantages of employee-sponsored individual policies can include:

- Guaranteed standard issue. A primary reason that firms 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, and what is the employee's smoking status?
Everyone who's not currently disabled is guaranteed to qualify.

- Contract language that protects an employee's specialty of practice. 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 professions. 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 percent.
- Nontaxable benefit payments.

- Catastrophic benefits that can replace up to 100 percent of income for the most serious types of disabilities.
- Portable coverage. The employee can keep the individual policy when he or she leaves the organization.
- 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 is an important feature and differs from coverage that is merely guaranteed renewable. Guaranteed renewable means that the employee has the right to renew the policy with the same benefits, but the insurer can increase premiums, so 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.



INNOVATIVE SOLUTIONS

Most employers offer the core group LTD that typically covers 60 percent of an employee's base salary up to a cap of \$3,000 - \$25,000. The graph below illustrates the benefit of adding an individual policy. Employees are able to cover "other" compensation like bonus, commissions, etc., which increases the total benefit they would receive if unable to work. It can also cover up to 100 percent of compensation if the disability is catastrophic.

Current Workforce Trends

Recent surveys, by insurance carriers, show that:

- Employees are extending their working careers, thereby extending the need for adequate income protection. With retirement age pushed back many employees are working into their late 60s and are in need of income protection through those older years. Most policies will cover an employee, who is working full time, between the ages of 65 and 70.
- Medical advances are extending life expectancy, resulting in disabling conditions that in the past had been fatal.
- There is an increasing responsibility for employees to fund their own retirement.
- The added pressure on the need for steady income throughout working years.

Data that insurance carriers have collected show that the most common causes of disability are:

- Top-three long-term illnesses: cancer, heart attack, and diabetes
- Back pain
- Arthritis

- Mental and nervous conditions
- Injuries

Note that most of the above causes are not work-related and, therefore, are not covered by worker's compensation.

Given that these are the most common disabilities, what are the chances that any one of us will become disabled? Actually higher than you might think! The following facts are culled from the Council for Disability Awareness:

- More than 30 million people in the United States between the ages of 21 and 64 are disabled, according to the Centers for Disease Control and Prevention.
- 2.3 million people filed disability claims with Social Security in 2008.
- 25+ million US lives are restricted by the effects of disability, according to the Centers for Disease Control and Prevention.
- Almost one-third of US workers entering the workforce today (three in ten) will become disabled before they retire.
- Almost one-third of US workers entering the workforce today (3 in 10) will become disabled before they retire.
- 8 million disabled wage earners, over 5 percent of US workers, were receiving Social Security Disability (SSDI) benefits at the end of June 2010.
- In June 2010, there were nearly 2.5 million disabled workers in their 20s, 30s, and 40s receiving SSDI benefits.

Case Illustration

A female, age 35, is diagnosed with breast cancer. Her doctor

recommends radiation treatment immediately. After weeks of radiation treatment, during which she is not able to work, the doctor recommends chemotherapy. She is still unable to work. When she finishes the chemotherapy she will need surgery, and is still unable to work. At minimum, three to four months have passed, and the employee has not been able to work. She now begins the healing process and stands to be out of work for another 6-12 months. More than likely her Group LTD plan had a 90-day elimination period (the period of time one has to be disabled before benefits will be paid), so for the first 90 days she had no income... Her benefits would start on the 91st day, but the first claim check would not arrive until 30 days after that. When the check arrives, it will be far less than she will need to maintain her lifestyle and pay back any debit needed to cover the first 90 days. It is critical that the employee have the maximum benefit available in the marketplace when benefits start so she is able to get back on her feet. The pain of going through an illness is hard enough – but the added pressure of not having income to pay bills while going through an illness is overwhelming.

SELECTING THE RIGHT INCOME-PROTECTION PLAN

Most employers provide a group LTD plan, which is a very cost-effective way to provide a basic level of income protection to all employees. However, individual income-protection plans provide features and benefits that complement the base group plan and provide more security for the employees. Combining these platforms can result in a more beneficial and comprehensive long-term income-protection program.

To determine whether an IDI would work for your organization, first select the right insurance agent/financial professional to work with your company. Often, the group-benefits insurance agent is not focused on the individual plans and has limited expertise with the product provisions.

Next, allow the agent to take a redacted census (a list of employees that eliminates employee names but includes information needed to

provide a price quote, e.g., date of birth, sex, state of residence, etc.) to the marketplace to determine the strongest and most competitive offer for the organization. Quotes are tailor-fitted to each individual organization, so requests for quotes will vary.

The next step is to survey to all employees and determine how many would be interested in a benefit that would position them to be more

financially secure should they be unable to work.

Finally, if you have 10 percent of your employees interested, you should at minimum offer a voluntary income-protection plan to them. Following this advice will greatly protect not only the health and welfare of your most valuable asset, your workforce, but the overall health and welfare of your organization as well.