

Need for Supplemental Disability Insurance

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As disability awareness month recently passed it is important to remember the value of disability insurance throughout the year. We never know which of our clients will die and which will live. The Social Security administration continues to administer a form of catastrophic disability benefits for eligible beneficiaries, however it usually requires inability to perform any other occupation on the planet and the impairment must be expected to last at least 12 months or result in death. This component is priced into our taxes on our federal wage base.

As the insurance industry tightens its belt, there are still multiple options for professionals. Obtaining coverage through a group is the easiest and most basic way of achieving 50 percent or 60 percent of income coverage while individual (IDI) coverage helps to provide portability and flexibility. Group long term disability if offered should be taken as a base benefit. It often offers 50 percent or 60 percent of income covered without any medical underwriting requirements. If the employer pays the premium, the benefit would become taxable to the employee, if disabled, because the employer would have taken an IRC 162 tax deduction for the premium. If you are an owner of an 'S' corporation or LLC member/partner you can be charged the premium on your K-1 and request the carrier assume this "gross up".

There is also usually a reduction of benefit if Social Security benefits are paid on either a primary or family basis. This is reasonable in that the employer has already paid at least half of the premiums for the S.S. disability benefits. Not integrating those payments would effectively provide double coverage. Some other key points to remember when reading a group disability contract:

1. Definition of earnings—does it cover bonus, qualified retirement plan contributions, overtime, and commission? If the coverage covers salary only and the insured is reliant on bonus income and a retirement plan contribution for his or her lifestyle it is important to make sure that that income is covered as well in some form.
2. Definition of disability—is it own occupation/regular occupation? Specialty specific?
3. Is there a mandatory rehabilitation requirement? Meaning does the client need to comply with a rehabilitation program in order to qualify for the benefit?
4. Portable or Convertible if you ever leave employment?

There is a monthly benefit cap usually in the range of \$5,000-\$15,000 per month.

Depending upon the client's income that may or may not be the 50 percent or 60 percent of income covered as advertised. That is where supplemental disability insurance would be of value. Market standards are 60 percent to 70 percent of income covered as maximums. This covers more income but still gives the professional an incentive to go back to work if they are able. Especially since some of it may be provided on a tax free basis, it may be closer to their take home pay.

Supplemental disability insurance coverage is purchased on an individual or multilife basis. While group may be guaranteed issue, individual coverage is underwritten meaning it would require blood/urine, physician's statements, etc. For those of you who have experience trying to underwrite coverage it can be quite an onerous process. Advisors who sell a lot of life insurance may find it easier to also ask whether clients have disability coverage. Since they are already going through the underwriting for life insurance, a few more forms can get them underwritten for disability insurance as well. The same paramedical exam may be used for the disability coverage.

Some of the key points to individual coverage are as follows:

1. Many contracts now are noncancelable and guaranteed renewable, which means they can never be canceled except due to fraud or nonpayment of premium and their premium is locked in at the age of purchase. If the carrier only offers guaranteed renewable the rates can only be changed if the state in which it is filed approves of a rate change. Instead of the rate hikes we usually see, carriers no longer offer a contract series and subsequently release a new contract with added benefits at a heftier price.
2. Own Occupation—not many carriers now offer true own occupation and those that do, offer it at a hefty premium. However, most carriers have modified their residual (partial disability) and “own occupation” contracts to consider income from “any other occupation”. So if one is disabled from his/her own occupation or specialty he/she would receive the full benefit as long as he/she does not choose to go back to work in another occupation, which would cause it to become a residual claim. If you have had the experience of filing claims with your clients you understand that most claims fall under a residual claim.
3. Most claims fall under residual benefits because professionals are inclined to go back to work to support themselves and their families. Claimants who choose to go back to work at something other than their own occupations are subject to residual benefits.

When applying for coverage providing the earned income is important in order to cover all eligible income. Even reviewing retirement contributions is important for both group and individual coverage. If a professional is unable to work, he/she is also unable to contribute to an employer-sponsored retirement plan package, and does not receive any match made to a 403(b) or 401(k) plan. If disabled early enough that decades worth of savings are missed, when the

disability benefits cease at age 65/66/67 the client is only left with Social Security to fund retirement. Purchasing a small benefit amount to fund at least an IRA can be a valuable concept for a professional.

The power of supplemental disability coverage can benefit not only the higher income earners but also the up and coming junior executives or junior partners. Many carriers offer a benefit that increases automatically or via an “option”. Because it is on a guaranteed basis and no new medical underwriting is required, it is an easy way for younger executives to lock in their insurability at a young age.

Many professional organizations and employers can provide extra discounts and/or gender neutral rating for their members and executives if three or more individuals wish to participate. Discounts usually range from five percent to 15 percent. The gender neutral rating holds more appeal to females as this can create an extra 10 percent to 20 percent discount by using male rates. Females are more likely to file a claim (approximately five percent of claims are due to complications from childbirth) and the greater likelihood of claim, the higher the premium. The Association plans are also usually cancelable by carrier and/or require membership to continue coverage. So it is important to know about the discounts before purchasing the coverage.

It is important to review group and individual disability coverage with professionals so clients know their options. Each carrier has what is called issue and participation limits, which means the maximum they will “issue” on an individual basis and the maximum they will “participate” to if the professional has other group or individual coverage. The current regular market maximum is at about \$25,000 to \$30,000/month of benefit. More can be obtained in the high-risk market at Lloyds of London. If a professional has group disability coverage in force,

the carrier will consider that amount of coverage when calculating the eligibility maximum. However, if the individual disability insurance is acquired first and group disability added-on later most group contracts will not offset. This can be of value to a professional who has a high income and is maxed out in the individual market but still wishes to obtain additional coverage. Because group is calculated based on a percentage of income it is easier to provide a base amount of individual coverage and then place group disability on top to allow for fluctuations of income.

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