# GROUP DISABILITY INCOME INSURANCE PLANNING: WHEN 60 PERCENT EQUALS 30 PERCENT AND WHAT TO DO ABOUT IT!

**By John Ryan CFP®**
**January 2020**

Employer-provided group long term disability (LTD) coverage is a great value. Premiums are often paid by the employer, and the coverage is usually better than you think. However, when a client tells you she is covered to 60 percent of their income, she is usually mistaken, as there are certain limitations and benefit offsets not easily identified at first glance. In this article, I want to highlight the typical shortcomings of group LTD and show advisors how best to overcome them.

## IMPORTANT QUESTIONS ABOUT GROUP LTD THAT CLIENTS NEED TO KNOW

First, let's cover a few basics and share a table showing typical advantages and disadvantages of group LTD (Fig. 1). Then we can decide how best to supplement LTD coverage.

**Q. What percentage of income is covered?**
A. 60 percent is a typical percentage.

**Q. What is the monthly benefit cap?**
A. The cap will depend on the size of the employer group, but can range from $5,000/month to $20,000/month.

**Q. What is the definition of disability, and does it change the longer a client is on claim?**
A. Most definitions change after two or five years of claim, starting with an "own occupation" definition (company pays if client can't work in their current occupation), then changing to an "any occupation" (company pays if client can't work in any occupation that is reasonable, based on prior education, training, and experience, and with regards to prior earnings level). This language is designed to prevent the insurer from canceling a claim because a person can work at a very low-level job. The list of jobs the claimant must be unable to acquire must be reasonable, based on their background, and they must be expected to earn at least 60 percent of their previous income within a 12-month period. Some contracts say 80 percent. This rules out "bottom-feeder" jobs.

**Q. Can the insurance company increase the premiums, modify the coverage, or cancel the policy?**
A. An insurer can usually take all of these measures, but an increase in premium to compensate for poor claim experience is by far the most likely.

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**Q. Can you convert the group policy to an individual plan if you leave the employer?**
A. Most LTD plans have a conversion option to an individual certificate, but these certificates are usually not as comprehensive as the LTD plan, and **always** cost more.

**Q. What are the benefit offsets?**
A. The most common offsets are Social Security benefits for which your client may be eligible, workers' compensation, state cash sickness payments, and a percentage of a client's earned income if they return to work. There are usually no earnings offset for 12 to 24 months, depending on the policy, then a 50-percent income offset.

**Q. Are there disabilities that are not eligible for benefit payments to age 65?**
A. Mental and nervous claims, as well as drug and alcohol claims, are almost always limited to a 24-month maximum benefit payment, unless hospital-confined longer than that. Also, claims classified as "subjective diagnosis" may be limited.

**Q. Are some losses not covered at all?**
A. Yes, these include self-inflicted injuries, losses from war or art of war, income loss from loss of professional license or incarceration, and a disability obtained while performing an illegal act. Note: It is very important to make sure your client is aware of all policy limitations and exclusions, and not just the costs and benefits.

**Q. What is the definition of income that the policy insures?**
A. Most LTD plans only cover base compensation, not bonuses or commissions, unless specifically requested by the employer. There are other forms of compensation that must also be considered, such as stock options and other incentive compensation, especially if there is a risk of forfeiture if disabled.

**Q. Does your client have the option of paying the LTD premium through payroll deduction, thus converting the taxable benefit to tax-free?**
A. Not all insurers allow this, but it is a good strategy, especially when a client can't qualify medically for a privately owned policy.

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**Fig. 1 Typical Advantages and Disadvantages of LTD Insurance**

| Advantages | Disadvantages |
|---|---|
| Low cost | Acceptance subject to a pre-existing exclusion clause |
| Guaranteed acceptance | |
| Benefits increase as income increases | Benefits can decrease as income decreases. |
| | Benefits are taxable to the insured |
| Own-occupation coverage can sometimes be to age 65 | Own-occupation protection is usually limited to two or five years |
| | Policy can be reprised or even canceled by the insurer |
| | Coverage is lost when leave employer |
| | Benefit offset by government programs like Social Security and workers compensation |
| | Usually no benefit cost-of-living adjustment when in claim |

## HOW 60 PERCENT PROTECTION BECOMES 30 PERCENT

Now, let's assume one of your clients comes to you with their LTD plan, and it's up to you to make sure they have the 60 percent tax-free income protection they need.

Scenario: Client, age 40, nonsmoker, great health, lives in Colorado, earns $240,000/year plus variable bonus (2017 bonus was $60,000). Occupation is VP of operations. Client goal: 60 percent tax-free monthly benefit.

Here's a typical LTD plan for such an individual:

- 90-day elimination period
- 60 percent of base compensation to a max of $10,000/month
- Benefits payable to Social Security normal retirement age (SSNRA)
- No cost-of-living adjustment rider
- "Own occupation" definition of disability to SSNRA
- Partial disability benefits included

This is a classic example of 60 percent equaling 30 percent, because: a) the monthly benefit cap is too low; b) the bonus is not insured; and c) the benefit is 100-percent taxable.

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## HOW TO GET 60 PERCENT TO EQUAL 60 PERCENT (PLUS)

You can get your client closer to the 60 percent tax-free benefit goal with a private disability plan with the following characteristics:

- 90-day elimination period
- $7,500 tax-free monthly benefit payable to age 67
- "Own occupation" protection to age 67
- Partial disability benefits included
- 3 percent cost of living adjustment when on claim
- Benefit update rider
- Catastrophic disability rider
- Annual premium: male $3,700, female $5,980
- Multi-life premium: M/F $3,500 (multi-life discounts available when three or more employees purchase some level of coverage simultaneously)

A private policy not only increases the tax-free monthly benefit of your client, but also solidifies the overall policy guarantees with comprehensive features that only are found in competitive private coverage (see Fig. 2). The downside is these policies are, in most cases, fully medically underwritten and they cost more than group LTD.

**Fig. 2 Typical Advantages and Disadvantages of Privately Owned Disability Insurance**

| **Advantages** | **Disadvantages** |
|---|---|
| Premium doesn't increase and policy can't be canceled | Higher cost |
| Portable protection if insured leaves employer | Full medical underwriting |
| Own-occupation protection to age 65, 67, and 70 | |
| More generous residuals (partial disability benefits) | |
| Benefits are tax free | |
| Cost-of-living benefit adjustment can be added | |
| Guaranteed benefit increase options (non-medical) | |
| Some additional no-cost features included | |
| Can insure all types of earned income, including incentive compensation | |

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An often-underrated feature of an individually owned policy is the benefit update, or "future increase option," as it is sometimes called. This rider allows your client to increase coverage in the future, no medical questions asked. This can be invaluable if your client leaves the employer, loses the group LTD, and has health issues that would prevent them from obtaining higher benefit limits through normal underwriting.

Here's one more option. Even if the group LTD plan tax-free monthly benefit is sufficient based on your client's needs, hedging the risk with some level of private coverage that has superior guarantee and is non-cancellable and portable, is not a bad idea. An income as low as $4,000/month can get a $1,000/month private policy to supplement a typical employer LTD plan.

Finally, Lloyds of London can supplement all domestic carrier disability protection up to 65% of earnings to a monthly benefit maximum of $100,000. A large lump-sum benefit (up to 5X monthly earnings) is also available once a claim exceeds 60 months.

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